

COMPETITIVE FORCES IN THE WHOLESALE
MARKETING OF PREPARED
FOOD PRODUCTS

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Analyzes Competitive Forces in the Wholesale Marketing of Prepared Food Products

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With this issue THE BULLETIN publishes the first installment of "Competitive Forces in the Wholesale Marketing of Prepared Food Products," by Mr. Nathaneal Howard Engle, School of Business Administration, The University of Michigan, Ann Arbor, Michigan. Further installments will be published in successive issues of THE BULLETIN until Mr. Engle's study, written in partial fulfillment of the requirements for the degree of Doctor of Philosophy in the University of Michigan, is completed.

Mr. Engle's study of the competitive forces of the wholesale marketing of prepared food products, unlike many academic theses, is based upon considerable practical experience. He has had the benefit of four years of actual participation in the wholesale grocery business in the Pacific Northwest as well as six additional years of study and teaching of economics and marketing. The practical, exhaustive, and timely character of Mr. Engle's survey can be indicated by reference to the table of contents. He has divided his study into four sections as follows:

Section I. "The Marketing Mechanism."

Part I. Marketing Functions.

Part II. Elements of the Marketing System.

Section II. "The Wholesale Grocer and His functions."

Section III. "Competitors for the Wholesale Grocer's Office."

Part I. The Manufacturer.

Part II. The Chain Store.

Part III. Cooperative Marketing.

Section IV. "The Permanence of the Wholesale Grocer."

Mr. Engle's study is illustrated by twelve charts as follows:

I. Typical Channels of Distribution.

II. Number of Wholesale Grocers in the United States.

III. Marketing Expenses of Grocery Manufacturers.

IV. Operating Expenses for Wholesale Grocers.

V. Operating Expenses for Retail Grocers.

VI. Comparison of Marketing Costs with Sales in Six Groups of Grocery Producing Firms.

VII. Hypothetical Marketing Expenses of a Merger of Producers of Food Stuffs. (Direct Selling.)

VIII. Indexes of Grocery Sales for Wholesalers and Chains.

IX. Average Operating Expenses for Two Chains, 1926. Pacific Northwest.

X. Operating Costs for Two Successful Grocery Chains.

XI. Sales of Cooperative Stores in the United States

XII. Trend of Sales of Cooperative Societies.

Readers of THE BULLETIN will appreciate that "Competitive Forces in the Wholesale Marketing of Prepared Food Products" was written from an impartial scientific viewpoint. It represents careful and scholarly consideration of modern competitive conditions in one of the basic trades of the country. Mr. Engle endeavors in this study to discuss and analyze

present-day tendencies and to indicate the permanence of the various experiments now being resorted to by the various factors in their efforts to dominate the food marketing system.

The first installment which is published herewith includes Sections I and II of Mr. Engle's thesis.

Editor's Note.

INTRODUCTION

There is probably no phase of modern American business which is subject to more adverse and ill-informed criticism than is the existing marketing mechanism. This is particularly true of the food industry wherein there is plenty of room for legitimate criticism. While it is undeniable that wastes exist in the marketing process it has yet to be substantiated that such wastes are more excessive than those in other phases of industry. All wastes should be eliminated and intelligent criticism directed toward their exposure should be welcomed, but unless such criticism be constructively aimed at a reduction of needless marketing costs it is quite unjustifiable. The wholesale grocer, for example, has been most severely condemned by critics both within and without the marketing fold. He has been singled out as the black sheep and maligned as a superfluous drag on the marketing process. Manufacturers on his one side and retailers on his other have attempted to eliminate him. Much of this criticism has been only too well earned but so little has been said on the wholesaler's behalf that he is almost universally condemned and held to be fast approaching befitting extinction. The writer has long felt that the above attitude was unreasonable and that a close examination of the facts might lead to a different conclusion. Several years' experience in the wholesale grocery trade had convinced him that the part played by the wholesaler was too important to justify his elimination. Subsequent study of economics and marketing problems from a more academic angle has not altered this conviction but rather strengthened it.

This thesis constitutes an attempt to examine all sides of the wholesale grocer's problem as a basis for constructive criticism. The author has sought to combine the purely theoretical with the various practical economic phases involved. The lack of inductive evidence has been a serious handicap on the practical side since statistics on the various divisions of the problem are either few or absent altogether. Available literature, chiefly in trade publications, has been consulted and supplemented by extensive discussion with business executives. Both of these sources are open to the objection of serious bias and the writer has had to perform a continual sifting process to divide the wheat from the chaff. His basis of practical experience in the grocery field coupled with his scientific training in economics has proved an invaluable aid in this process.

If business men generally in the field of marketing hope to profit from the application of scientific methods to their many problems they must change their attitude radically. The majority of those now engaged in the food products trade either do not have the data necessary for statistical analysis or will not permit its use for the benefit of the industry. The former sadly lacks modern accounting systems while the latter must learn that only as they are willing to cooperate in pooling the actual fact of their business with impartial investigating agencies, such as the Department of Commerce, educational research bureaus, or trade associations, can they hope to learn the truth about their own business and so raise its level of efficiency and improve their own positions.

For whatever virtue this study may have the writer wishes to acknowledge his indebtedness to his teachers and colleagues both at the University of Washington and the University of Michigan. His understanding of economic theory begun under Professor W. D. Moriarty, at Washington, has been broadened and strengthened under the guidance of Professor Fred M. Taylor, of Michigan, whose kindly but rigid discipline has been of incalculable value. In the special field of marketing preliminary work, also under Professor Moriarty, has been supplemented and expanded by study with Dean C. E. Griffin, of Michigan, whose interest and advice have greatly facilitated work on this thesis. Professor Z. C. Dickinson and many others at Michigan, particularly the author's wife, have rendered helpful assistance at various points.

Practical Advisors

In the field of active business a number of grocery executives are deserving of thanks for the time they have freely given to discussions of their problems. In particular the author wants to thank Mr. W. F. Lee, of the Lee Grocery Company, Everett, Washington; Mr. Hilding Lindberg, of the Standard Grocery Company, Tacoma, Washington; Mr. Brooks Holliday, with Beechnut Packing Company, Detroit, Michigan; Mr. E. A. Elliott, of the National Grocery Company, Detroit, and Mr. F. A. Dalton, of Toledo, Ohio, all of whom have been of no little help in making this study possible.

The author's conclusions, briefly set forth, are that the independent wholesaler grocer will probably never be entirely displaced. Although he is threatened from two opposite angles he occupies a strategically defensible position. Efforts to dislodge him by manufacturers who seek direct outlets are hampered by the fact that manufacturers cannot perform his functions on anything like as economical a basis as can the wholesaler himself. On the other hand the outlet of the wholesale grocer has already been considerably reduced by the activities of chain store systems which combine wholesale and retail functions and apparently perform both sets of activities at a lower cost than the independents. But the success of the chains has resulted from lower prices to consumers based on certain advantages in buying and certain economies in selling. An examination of the former shows them to have been greatly overestimated and not at all beyond the attainment of independent wholesalers and retailers.

Two Economies

The selling economies seems to be closely linked with two of the chain store policies, the standardized marketing of a relatively few staple products, and cash-and-carry selling. Both of these methods may be successfully adopted by independent merchants, a fact which makes possible competition that must tend to check the expansion of the chain. If the chains cling to these policies their growth is limited by the demand for cash-and-carry selling of staple products. This demand may be estimated at some 50% of the trade of the United States by an examination of figures showing distribution of income. On the other hand, if the chains depart from these policies their selling costs must increase and their competitive advantage must be weakened. Furthermore, independent wholesalers have found that they can strengthen their outlets by educating the retailers to greater efficiency and by practising more efficient methods themselves, as well as by resort to cash-and-carry wholesaling and voluntary chain systems.

In the final analysis it is concluded that there is room for an independent wholesaler in our marketing system provided he be willing to recognize changing business conditions and to adjust himself intelligently to them.

Section I. THE MARKETING MECHANISM

Part I. Marketing Functions

The functions of the marketing process from the standpoint of economic theory fall under the categories of production and distribution. From the former angle of approach the marketing system may be said to perform a dual function. In the first place, as the extension of the principle of specialization, namely that specialization was pointed out by Adam Smith (*) conduces to increased productive efficiency and hence to a fuller satisfaction of human wants, is conditioned upon a marketing system. Hence, conversely, the marketing mechanism is causal to specialization. No lengthy argument is needed to support this statement. To permit individuals and communities to devote their entire time and energy to the performance of a single, or at most a very few tasks, with the resultant increase in technical efficiency and output, necessitates some sort of provision whereby they may dispose of their excess product and obtain those products of others essential to a fuller satisfaction of their wants. The marketing system constitutes such a provision. By so doing it performs a final step in the productive process. The exchanged products by this means have their power to satisfy human wants enhanced to no little degree. Producers of one commodity find that the utility of that commodity becomes less and less to them as the quantity of it increases. By disposing of surplus units of this commodity which have little utility, through exchange with producers likewise situated with respect to other products, greater economic well-being accrues to both exchanger and exchangee since the exchanged commodities take on added utility by the process of trade. Since specialization is only possible when such exchange exists, one function of the marketing mechanism, then, is to make possible a fuller realization of the principle of specialization.

Importance of Marketing

The second of the dual functions referred to performs an equally vital part in our economic life. The marketing system may be said to consist of

* Book I, Chapter III "The Wealth of Nations."

a multiplicity of forces which determine the demand and supply schedules for economic goods, services and factors of production. It is in the market that these forces focus and values emerge, prices are established, for all economic factors and products. The importance of this process cannot be overestimated. Since the supply of primary economic factors of production is not unlimited, whereas our wants for economic goods and services, the products of the cooperation of these factors know no bounds, we must necessarily make a selection among our wants so that the more important ones shall not go unsatisfied. This essential selection is automatically consummated by the marketing mechanism, which properly allocates the limited supply of productive factors to the tasks of producing only those products which, economically speaking, should be produced. Only those goods and services should be continuously supplied which show in their prices a degree of utility at least high enough to cover their cost of production. Goods which show a lesser degree of utility, although they may and frequently do appear on the market, will not be able to command prices as high as their marginal cost. The loss incurred by the producers of such goods will soon force their elimination from the market.

Thus, from the point of view of production, the marketing function is seen to be at once causal in that the marketing system is an essential condition to continued specialization; and corrective, in that it provides the mechanism which prevents the continued production of those goods which have marginal significances lower than their marginal costs of production.

Additional Functions

With the attitude of the economic theorist still in mind there are yet other functions to be imputed to the marketing mechanism, those above referred to as falling under the head of distribution. *Since the subject matter of distribution has to do with the determination of the allocation of total social income among the functional agents of production, and since this is primarily a value problem, its connection with the marketing mechanism should be clear. The income of each agent of production is in effect

the price of that factor of production which is controlled by the agent in question. As was noted above the prices of factors of production are determined by the marketing mechanism, hence money incomes are determined by the marketing system. But this is not all. Not only does the marketing mechanism determine the money incomes of the agents of production, it also determines in a large measure the real income as well. By real income is meant goods and services for which money income is exchanged. The quantity of such goods and services which can be commanded by a given income must vary inversely with the prices of such goods and services. But these prices too are determined by the marketing forces, hence the latter may be said to be determinative of real incomes as well as of functional money incomes.

Thus it is clear that the marketing mechanism performs important functions under the two major economic categories of Production and Distribution. Under the former it contributes to greater productive efficiency by making possible increased specialization and in addition it regulates production by preventing the continued appearance of products which, economically speaking, should not be produced. Under the second category this same marketing mechanism is determinative of both money and real incomes.

Technical Functions

From the point of view of marketing theory the marketing functions are generally said to consist of the creation of form, time, place and ownership utilities. These are obviously subdivisions of the first economic function above discussed, namely the creation of the final degree of utility making possible specialization. These utilities are the outcome of certain technical functions such as the assembling of products, the physical distribution of products, the grading, sorting and standardization of products, and financing and assumption of risk. Professor F. E. Clark classifies them admirably under the three headings of Functions of Exchange, Functions of Physical Distribution and Auxiliary Functions.*

These more superficial functions of the marketing process will be considered at greater length in connection with the analysis of the marketing system which follows:

Part II. Elements of the Marketing System

The marketing system in general may be said to consist of three main elements, the producer, the middleman, and the consumer. The producer may be called primary, such as the farmer or miner, or secondary, such as the manufacturer. His chief function is to create form utility, since he specializes in converting products into forms more suitable for the satisfaction of human wants. He provides the source of supply for the middleman.

The middleman's function is divided among many agents. Among them may be mentioned manufacturer's agents, brokers, wholesalers, jobbers, commission men, retailers. Thus a high degree of specialization is seen to exist in the performance of the middleman's function. In general that function consists of the production of utilities of time, place and ownership. These utilities are produced through the technical functions of assembling the products of the producer, grading and sorting, storing, transporting, "carrying", or performing the capital function, redistributing, and withal the assumption of risks of various sorts.

The Third Element

The third element in the marketing system, the consumer, completes the marketing process. The marketing system exists for him, its primary purpose being the fuller satisfaction of his wants. His wants can be fully satisfied only when he completes the chain of exchanges, set up by himself as a specialized producer, by purchasing from the middleman those products which he requires. His cooperation is thus seen to be essential to the creation of the final stage of utility above discussed. Furthermore, since it is his wants which are to be satisfied by the marketing system he has an important function to perform in the determination of what goods shall be produced. It is the consumer's demand schedules which, transmitted by means of the middleman, inform the producer which commodities to produce and which not to produce.

So much for the marketing system in general. A more complete elaboration of marketing functions as observed in a specific market, such as that for prepared food products, will serve the

* These functions are discussed by W. D. Moriarty, "Economics of Marketing and Advertising," Chap. I and XXII. Also in "Principles of Economics," by F. M. Taylor, Chapter 36.

* "Principles of Marketing," Chapter II. Macmillan, 1922.

double purpose of giving a clearer concept of the marketing mechanism and of elucidating the particular problem of this paper, the problem of the wholesale grocer. Consequently the grocery market will next be examined in detail.

Manufacturer's Function

The accompanying highly schematic diagram, Chart I, serves to assist in visualizing the situation as a whole. In the grocery trade the producer is the manufacturer, the processor, or importer of food products. The creation of form utility is to be imputed to him as his primary function. He takes the raw foodstuffs and converts them into products susceptible of the immediate satisfaction of consumer wants.* The performance of this function involves certain other functions. The manufacturer must provide "waiting" or "carry-

* This statement does not mean to ignore the necessary preparation of food products by the housewife.

ing power" by investing capital in plant, equipment, and reserve stocks of raw materials. He must also assume the responsibility and risk of production including ownership of the final product. Certain incidental technical functions are likewise involved. The raw materials must frequently be graded and sorted. Satisfactory storage provision must be made for both surplus stocks of raw materials and for at least some of the finished product. The manufacturing process itself performs the function of standardization by turning out thousands of identical units such as packages of corn flakes, cans of fruit, sacks of flour. Finally, the producer must perform a selling function for he must at least start his product on its way to the consumer by disposing of it to the middleman.

As Chart No. One indicates there are three possible channels of distribution open to the producer. He may sell his product to the wholesaler,

the more usual way; to a broker or agent; or to the retailer direct. When the outlet is by way of the wholesale grocer the latter relieves the producer to a large extent of owning and carrying the final product. By so doing he assumes certain business risks which would otherwise rest on the producer. In brief, the wholesaler's task consists in the assembling of the products of many producers and the redistributing of these products to his many retailer customers. These functions of the wholesaler will be dealt with more specifically in the next section.

Manufacturer's Agents

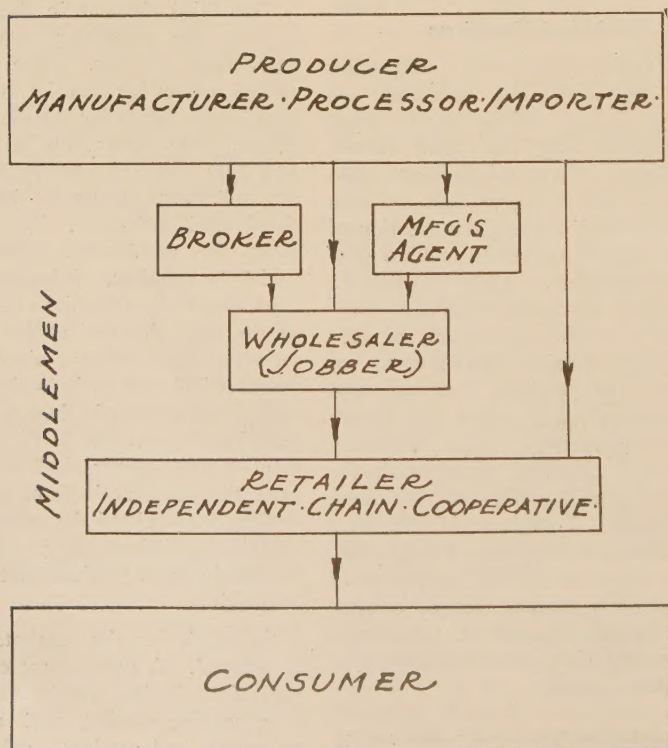
The second option of the producer will now be considered, namely the brokers and manufacturer's agents who are frequently made use of by the producer as a means of outlet for his product. Especially wherever there are many small-scale manufacturers or processors with relatively small output per plant is it customary to utilize the services of these middlemen. Their function is chiefly a selling one. They list the output of the small canners, sugar refiners, or fruit packers, who are their clients, and take orders from wholesale grocers for these various products. They generally do this in advance of actual production, thus affording both wholesalers and producers valuable information regarding the demand and supply situations with reference to the goods they handle.

The broker or agent very rarely buys the output of the producer outright. Neither does he provide storage or transportation facilities since the orders he secures from the wholesaler are sent to the producer to be shipped by him from his plant directly to the wholesaler. The broker or agent receives a commission for his services. This type of middleman requires very little capital to enter business. He performs none of the "carrying" function and assumes little or no risk. His stock in trade is a widespread acquaintance among wholesale dealers and producers and a thorough knowledge of marketing conditions. His chief function, then, is seen to lie in the creation of ownership utility and in contributing to a better knowledge of supply and demand forces and hence to the determination of a more truly normal price.

There remains to be considered still a third alternative open to the producer for the disposal of his product. He may eliminate both of the two preceding groups of middlemen and sell directly

• CHART • ONE •

TYPICAL CHANNELS OF DISTRIBUTION FOR PREPARED FOOD PRODUCTS



to the retail grocer. When this channel is chosen, however, the functions performed by broker and wholesaler must be assumed by either the producer or the retailer. The latter is seldom in a position to assume any of these burdens. He has his hands well occupied in satisfying the exacting demands of the consumer, and interpreting them to the wholesaler and producer. Furthermore, he is under no necessity of buying from the producer as long as there is a conveniently located wholesaler ready and willing to serve him. The producer then finds that he must provide the necessary storage and transportation facilities to care for the retailer's demands. He must provide the retailer with credit if the latter insists on it and thus is apt to find himself burdened with a greater capital load and the additional risk.

Much Specialization

The marketing system for prepared food products is thus seen to be subdivided into several specialized elements, each of which assumes specific marketing functions. These elements constitute separate links in the marketing chain, about which so much of criticism has been and is being offered. The weak link in this chain according to these critics is the middleman, especially the wholesale middleman. The chain must be strengthened, it is urged, by removing this weak link and shortening the chain by that much. It is this link then, and the function it performs, which needs particular scrutiny. An examination of the wholesale grocer's position, and the nature of his office will constitute the subject matter of the following section.

Section II.

THE WHOLESALE GROCER AND HIS FUNCTIONS

The foregoing analysis of the marketing system for prepared food products has revealed the fact that a high degree of specialization has developed in that industry. Of the specialized agents in distribution none has assumed a more important role than the wholesale grocer. It may prove helpful to an understanding of his present position to revert to the earlier situation in this country.

The Mercantilist school of economics dominated world thinking during the early colonial history of American

growth. In harmony with its doctrines colonies were considered as outlets for the products of the home country and as a result were encouraged to produce only raw materials needed by the parent land. Manufacturing was discouraged and in fact, made illegal, while pressure was brought to bear on the colonists to buy English goods. Such a situation would tend to drive capital into trade rather than manufacturing. Large importing concerns naturally sprang up to handle the goods from the mother land and other outside sources. By the time manufacturing did develop, after the Revolution, these concerns were well established and in an excellent position to assume the wholesaler's position and maintain supremacy in the marketing system under the new regime of laissez-faire. It was not until 1787, however, that a distinct separation took place between manufacturer, wholesaler, and retailer, and wholesale markets appeared in America.*

Early Marketing

With the growth of the wholesale market the wholesale merchant assumed a position of great importance in the marketing process. Commons tells us that prices were entirely at the wholesaler's mercy and that the manufacturer played but a subordinate part in the marketing chain. Manufacturing was usually small-scale, and the manufacturer had his attentions entirely occupied with problems of capital raising and production. He was glad to have some one in the position of the wholesaler to relieve him of all selling problems. Once he had received his money from the wholesaler his interest in the product ceased. What the wholesaler did with it was no concern of his, much less the subsequent channels it followed in its course to the ultimate consumer.

The marketing chain thus early established was from the manufacturer to the wholesaler, and from the latter to the retailer, and finally to the consumer. This system has continued to be the regular method of distribution down to very recent times and still is so-called by the conservative student and tradesman. Thus it is clear that ever since the beginning of the industrial revolution, and no doubt much earlier if one could trace it, there has been a noticeable emphasis on the sub-division of functions. The manufacturer has concerned himself more and more with those technical aspects of his business

which lead to more efficient production, leaving to other agencies such as the wholesaler, the problems of distribution of the product. Thus specialization in production has made necessary specialization in distribution, and specialization in distribution has made possible more highly specialized production.

Wholesaler's Position

But one of these specialized agents, the wholesaler* whom we have seen to have occupied so important a position in the past, has of late had his prestige so seriously questioned that it is quite commonly believed that he will soon be superseded by other agents. A survey of the facts, however, does not give this view much support. Chart II shows the number of wholesale grocers in the United States for a period of five years, and while some decline is noticeable since 1924 the rate of decrease is not great enough to justify the belief of any very sudden disappearance of the wholesaler. Furthermore, examination of data from the same source** shows a territorial expansion of wholesalers, there being an increase in the number of cities in which wholesale grocers are found from 2,254 in 1924 to 2,364 in 1928. This tendency is in keeping with a noticeable trend towards localization in marketing generally, fostered by recent developments in transportation and the post war policy of hand-to-mouth buying. But if the wholesaler is to remain it must be because he performs necessary marketing functions. Let us examine first the nature of his functions and thereafter his fitness for performing them.

The essential nature of the wholesale grocer's position can well be illustrated by following through the imaginary organization of an individual wholesale house. Assuming that a satisfactory territory, one in which there is room for another wholesale house, is known, one of the first problems confronting the entrepreneur is the location of his warehouse. Since the nature of the wholesaler's business is service to retailers and producers alike he must plan to locate his place of business where he can render a maximum of service. He must be located as centrally as possible with relation to his customers and at the same time he must be in close prox-

* Wholesalers are frequently classified on a geographical basis as National, Sectional or Local. We will consider the general situation first, noting separate classes as need arises.

* Commons, J. F. "History of Labor in the United States."

** Data from Thomas' Register of Wholesale Grocers, 1928.

imity to the main transportation lines over which he receives his supplies from producers.

Large Reserve Stocks

It is an essential feature of the food products industry that large stocks of reserve goods must be maintained throughout a large part of the year. This situation is an outgrowth of the seasonal nature of the production of raw foodstuffs. Hence, in addition to the settlement of choice of location of his warehouse the wholesaler must also give particular attention to its capacity and storage facilities. When it is recalled that the wholesale grocer carries several thousand different items* many of which are obtainable only at certain seasons of the year, it is evident that this situation involves many difficulties. In addition to the general problem of adequate storage provision the wholesaler must work out a host of technical details. The physical arrangement of the stock in the warehouse is an illustration. Some products are light and bulky, others heavy in proportion to size of container. Some products deteriorate more rapidly than others and hence must be given special care. Some of these goods can be purchased only once a year and consequently must be bought in large quantities; others can be bought in small lots at any time.

Once the wholesaler has decided upon the location and plan of his warehouse he is next confronted with the difficult task of assembling his stock of merchandise. Buying is one of the most important and intricate of the wholesaler's problems. Beyond a few staple products the solution of what to buy varies with different communities.

* Many items are different only in respect to brand or size of container. The average number is about 4,000.

Before the wholesaler can solve it he must have carefully analyzed the consumer demand in his territory. Race, nationality, religion, education and the like must be considered in relation to their effect on the demands of consumers. But the buyer's work is not finished by any means when he has decided upon what he will buy. How much to buy and where to buy it needs to be determined. The quantities of the various products cannot be accurately ascertained in advance of experience. The method of trial and error being resorted to at first, a satisfactory solution will gradually emerge if thorough records are kept. Finally, with respect to buying sources, the wholesaler may find assistance in many published guides, list of manufacturers, and similar publications. Nevertheless, experience must again be relied upon to a very large extent.

Diversified Staff

Once our imaginary wholesaler has hit upon at least a temporary solution to each of the foregoing problems there still remain several other preliminary matters to arrange before he can start business. He must provide himself with a competent sales force, a traffic staff, warehouse men, and an accounting department.

Selling is often rated as the most vital aspect of the wholesaler's business. It is certainly coordinate in importance with buying since a failure in either of these departments may easily result in disaster. Great care must be exercised in choosing a sales executive and field salesmen, and in the subdivision and allotment of the territory, closely allied in significance is the traffic department. Not only must all incoming merchandise be checked and unloaded efficiently and quickly but all outgoing orders must be expeditiously handled as well,

since the delivery service to retailers plays no small part in the development of good will for the firm.

The successful service of the latter department is tied up very closely with the character of the warehouse department, whose function is to care for the merchandise within the building; to fill all orders; and to have them so placed that the traffic men can deliver them. Incoming cars can be unloaded no faster than the warehouse force stows the goods away. Neither can the shipping or delivering of outgoing orders be any faster than their preparation by the warehouse department. Because of these facts one man is frequently put in charge of both traffic and warehouse departments. Finally an accounting department is essential not only to determine costs and profits but to co-ordinate the activities of the separate departments.

Intelligent Plan

Successful coordination can be furthered by the wholesaler if he will outline in advance fairly definite policies of business procedure for each branch of his business. The major problems of the wholesale grocer have received no little attention from various research agencies and the results of these investigations are available as guides to the wholesaler who may desire to formulate such policies.*

Once our wholesaler has judiciously considered the foregoing suggestions and determined upon an intelligent plan of action he is ready to open his doors to the public. His sales force must first be sent out to call upon the retail merchants in his territory. Little business should be anticipated from the preliminary calls. The paramount task of the sales force for quite some time will be an endeavor to cultivate goodwill for the new firm. Some orders

Chart II.*

NUMBER OF WHOLESALE GROCERS IN THE UNITED STATES, BY CLASSES†, 1924-1928

Class	1928	1927	1926	1925	1924
A	2,857	2,929	3,019	3,079	3,129
B	1,362	1,346	1,323	1,235	1,177
C	1,958	2,032	2,030	2,045	2,056
Total	6,177	6,307	6,372	6,359	6,362

† Class A Wholesalers are those dealers who handle groceries only and sell to merchants only, employing salesmen, and maintaining warehouses.

Class B Wholesalers may handle other than strictly grocery products, and may be partially owned (up to 25 per cent) by retailers.

Class C Wholesalers include dealers who also sell at retail, chain buying departments, and cooperatively owned retail buying associations.

* Ibid.

* The Harvard Bureau of Business Research has prepared and recommended a uniform accounting system for wholesale grocers, and has published several studies on the costs of grocery wholesaling for the country at large. Similar cost studies, but more restricted in scope, have been prepared by the Bureaus of Business Research of the Universities of Nebraska and Ohio State. Furthermore, the Southern Wholesale Grocers' Association under the direction of Dr. C. S. Duncan has printed a series of five bulletins, each of which deals with a specific problem of the wholesale grocer. Two of the bulletins treat problems within the selling department, the problem of sales management and the methods of remunerating salesmen. The other three deal with warehousing problems such as those of stock turnover, the perpetual inventory system, and the broken package room. The Department of Commerce has likewise made quite a number of studies valuable to the wholesaler, notable among which may be cited the 'Atlas of Wholesale Grocery Territories.'

will flow in, however, from the very first and the service of the new house will be tested. Eventually, if prices, goods, and service prove to be satisfactory a foundation for a good business may be laid. Nevertheless it would normally require two or three years before any great amount of pecuniary success could be expected. The period of trial would be of longer or shorter duration in inverse proportion to the need of the community for additional wholesale service.

Serves Three Groups

In conclusion let us consider the functions of our hypothetical wholesale grocer with reference to each of the three groups he serves, the manufacturer, the retailer, the consumer. In the first place he would relieve the manufacturer of much of the burden of ownership of the finished product, because the manufacturer quite frequently disposes of the major part of his product to the wholesaler in advance of actual production. He takes the wholesaler's orders and ships the product as fast as his plant can turn it out. At the same time he either bills the wholesaler for the amount of the order or draws a draft on him and gets his money immediately from the bank. This relieves the manufacturer of no inconsiderable capital burden which he would have to bear himself if there were no wholesale middleman. By so doing the wholesaler further performs two other closely related yet quite distinct functions, the warehousing of the product, and the transportation or delivery of the product to the retailer. As to the first of these incidental functions the wholesaler effects a genuine service for the manufacturer. If the latter could not ship his output directly to the middleman he would either have to provide adequate storage facilities at his plant or he would have to build or hire such facilities at strategic distribution points throughout his territory. If he hoped for anything approximating national distribution he would be unable to avoid the latter alternative.*

By analogous reasoning, it can be shown that the manufacturer would have to provide a delivery service such as the wholesaler now performs for him. The average retailer has neither

the time nor the facilities to call for all of the goods he orders, either at a local warehouse or at a freight station.

Large Economies

But there are also other important services performed by our wholesaler for the producer. Without the wholesaler the manufacturer would have to find his own market which would involve a greatly increased sales force, increased accounting expense, and much larger capital requirements to care for the extension of credit to retailers. These factors would make national distribution all but impossible for any but the financially powerful producers. But all of these services are performed for the manufacturer by the wholesaler who is a specialist in carrying the reserves of food for the nation and in performing all functions incidental thereto. The producer is thus left free to specialize in the perfecting of his product and his processes.

Not only does the performance of the wholesaling function result in numerous advantages to the producer, but the retailer is also greatly benefited by the existing arrangement. If there were no wholesaler the retailer would have to buy directly from the producer. This might be quite satisfactory as far as some of his stock is concerned, because some products are kept in warehouses in close proximity to him. This would be true, however, only if he were notified of their existence and left alone. But the manufacturer would hardly consent to such a procedure. To have his salesmen call on all the retailers they could reach would be his goal. Each retailer would find that his time would be taken up talking to producer's salesmen. There would thus be additional complication after manufacturers had secured national distribution. The average retailer would prefer the half-dozen salesmen of competing wholesale firms in his territory to the score or more of manufacturer's salesmen from all over the country.

Necessary to Retailer

But even greater difficulties suggest themselves from the retailer's point of view. Only a very few of the goods he needs could conceivably have national distribution on such a scale as to have stocks available generally in local warehouses. The retailer would want many products the producers of which he could not even locate. The

wholesaler comes to his rescue by providing what amounts to a buying department for him. The retailer is thus enabled to purchase from one firm, in one order, the products of many manufacturers. He gains, in addition, more prompt and efficient delivery service. In a few hours at most he can have his telephone order delivered to his storeroom by the wholesaler whereas he would otherwise have to send his orders to distant manufacturers far in advance of his needs for the goods. Moreover he secures the goods more cheaply, since the wholesaler assembles them in car load lots and thus reduces transportation charges. Competition among wholesalers tends to assure that this saving will be passed on to the retailer. Again, the wholesaler fills orders for much smaller quantities than would the manufacturer. Cases are frequently broken and as few as one or two retail packages are sold to the retailer. Hence it is possible for the retailer to reduce his stock of goods to a minimum far below that which would be required if he dealt directly with the manufacturer. He thus is in a better position to reduce operating expenses and increase his turnover.

Again, the retailer is served by the wholesaler on the scores of credit and risk. Many retailers in the grocery trade have no banking connections whatever but rely solely on the wholesale house for credit. Finally the wholesale grocer serves the retailer by rendering an important educational function. The wholesale salesman keeps his customers posted as to the latest market information and, fully as important, as to the newer developments in business practice. Informed advice is frequently given regarding store management, stock taking, turnover, marketing, and accounting procedure in general. The retailer is urged to buy only those goods which he can dispose of quickly and at a profit. This type of information coming from the representative of the wholesale house is much more likely to be based on a knowledge of the retailer's community and problems than is that furnished by a manufacturer's specialty man. The latter cannot be expected to be as intimate with conditions in any one section. Neither can he be expected to have as impartial an attitude toward "brands" as the wholesale salesman. The latter handles many brands and is chiefly interested in selling the retailer only what the latter can sell.*

* Manufacturer's who have sought to eliminate the wholesaler have actually made use of both methods implied in the second alternative. That is, they have owned their own warehouses, or have made use of privately owned warehouse companies.

Summarizes Duties

In summary, the wholesale grocer serves the manufacturer by assuming the burden of ownership for him, by transporting and storing his product, by acting as his selling agent, and by assuming credit liabilities for him. On the other hand, the retailer is provided with a buying agent in the person of the wholesaler who assembles and carries reserve stocks of many products for him, provides him with delivery service, and reduced transportation costs, extends credit to him, and finally gives him valuable market information and advice on business management.

Thus far the wholesaler grocer's functions have been examined from the standpoint of their practical value to other elements in the marketing system, but now the more broadly social aspect of the wholesaler's function must be investigated. The question here is, "Does the wholesale grocer contribute to the better and fuller satisfaction of the wants of consumers?" The answer must certainly be that he does.

Consumers are insistent on having their wants satisfied here and now. When a housewife goes to the grocery store to get a can of peaches for dinner she does not like to be told that

the store is out of peaches but will be glad to take her order and get some for her by the next week. She wants them now! But if the store is to have the peaches now, someone must buy them from the cannery at the time they are canned, someone must transport them to the locality where the housewife resides and store them until such time as it pleases her to call for them.

Vastness of Problems

Someone must invest capital in these reserve stocks, assume the risk of spoilage, deterioration, and the possibility that she may want pears instead, and perform such other incidental services as may be necessary to insure the housewife her peaches when she wants them. Multiply this product by three or four thousand and the customer by several million and the vastness of the problem is at once apparent. Some agency must perform all of the functions just mentioned for all of the products handled by the grocery trade and demanded by consumers. Otherwise the wants of the latter will not be adequately cared for. At the present time the wholesale grocer is specializing in the performance of these functions. Whether or not he will

* Some salesmen no doubt still follow the policy of "loading up" the retailer but the trade generally frowns upon this practice.

continue to do so, and hence continue to exist as a separate part of the marketing system, will depend solely on his power to maintain himself in the face of the criticism and the competition to which he is being exposed, provided always that other conditions remain unchanged. If the principle of specialization holds true the presumption is in favor of his continuance. Regardless of the outcome, however, there is one point which must be emphasized. The wholesale grocer is today executing important economic functions. The complete elimination of the wholesale grocer as we know him will not, can not, eliminate these functions. They must continue to be performed by someone. Various competitive forces are at work in the marketing system which are tending to eliminate the existing wholesale grocer. It is proposed in the remainder of this thesis to investigate these forces in an effort to arrive at an answer to the question: Will the wholesale grocer survive as a distinct link in the marketing chain?

The next section will discuss in turn the manufacturer, the chain store, and the cooperatives, each of whom is striving to displace the "regular" wholesale grocer through the assumption of his functions.

(To Be Continued in December Issue)

Analyzes Possibilities of Manufacturer Usurping Basic Functions of Wholesaler

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Section III.

COMPETITORS FOR THE WHOLESALE GROCER'S OFFICE

Part I. The Manufacturer

quate to meet the requirements imposed by the new industrial growth.

The manufacturer-wholesaler-retailer chain of distribution which has been referred to heretofore as the "regular" system was not called into serious question until the latter part of the nineteenth century. What criticism there was came largely from extra-industrial sources. It was not until very recently that certain elements within the trade began to take stock of the situation and to offer objections to the existing marketing order. Certain changes of far-reaching importance had been taking place in our economic life. Manufacturing, transportation, and marketing processes were expanding concomitantly; and each, by its growth, contributed to the further development of the others. This expansion of trade and industry resulted in an ever-increasing degree of specialization, both inter and intra-industrial in character. More and more the attention of the manufacturer was centered on production, and that of the wholesaler and retailer on their specific marketing functions. A marked increase in the flow of products to the consumer resulted. But this very expansion set up strains within the marketing structure which have caused the various elements composing it serious concern.

That is, this interdependent development of economic phenomena brought about conditions which soon threatened the dominance of the established sequence in the chain of distribution of manufactured products and it began to appear that the marketing system of an earlier economy was becoming inadequate. The wholesaler in particular soon found

THE BULLETIN presents here the second installment of "Competitive Forces in the Wholesale Marketing of Prepared Food Products," by Nathanael Howard Engle, School of Business Administration, University of Michigan. Mr. Engle has made this timely study from the scientific viewpoint, and in addition he has had the advantage of several years of practical experience in the food business.

The first installment, which appeared in the November issue of THE BULLETIN, included Mr. Engle's Introduction, Section I, "The Marketing Mechanism" and Section II, "The Wholesale Grocer and His Function." In this installment Section III, "Competitors for the Wholesale Grocer's Office," is started. Part One—The Manufacturer—of Section III is completed in this issue. Subsequent issues will present Parts Two and Three, "The Chain Store" and "Cooperative Marketing" and also Section IV, "The Permanence of the Wholesale Grocer."

—Editor's Note.

his hitherto impregnable position subjected to attack by manufacturing interests with a resulting break in the marketing structure as an imminent possibility.

Wholesaler's Dilemma

From a mere handful of small scale producers the manufacturers of prepared food products have become legion.* The wholesaler has been assailed by a host of producers, each clamoring for a larger and larger share of his attention. He has been unable to discriminate to any great extent between manufacturers' products and as a result the manufacturers have accused him of failure properly to perform his func-

tions, which, in their eyes, consist of stocking and pushing their lines.

The wholesaler's functions, it must be recalled, are primarily to act as intermediary between manufacturer and retailer and to carry the reserves of food products for the community. This position necessitates the performance of various services for both extremes of the system. In addition to the general exchange function of buying and selling he must provide storage or warehouse facilities and perform certain financial functions for both manufacturer and retailer through the extension of credit and assumption of various credit and other risks. Whether or not the manufacturer is entirely justified in his criticism of the wholesaler depends upon the emphasis one lays on certain of the wholesaler's functions. If selling the manufacturer's products be considered his chief *raison d'être* then there may be some justification for the manufacturer's position. But, if it is believed that the wholesaler owes his right to exist to the supplying in a convenient place of such articles and in such quantities as the retailers, and ultimately the consumers, may desire, the case for the manufacturer is not so clear. As the situation is today, with thousands of retailers on the one hand and a host of manufacturers on the other, it seems that this latter function, if not paramount, is at least very great in importance. On this theory the wholesaler is not to be legitimately criticized for failure to push the brand of any one manufacturer. If it can be shown that the wholesaler is adequately supplying the demands from his territory he is very properly fulfilling his chief function.

* A careful selection of sixteen national associations of food products manufacturers out of an extensive list published by the U. S. Department of Commerce in "Commercial and Industrial Organizations of the United States", Domestic Commerce Series, Number 5, June, 1926, shows a membership of 7,474 manufacturers. The total of those who do not belong to such associations would no doubt increase the number very greatly.

Whether justified or not, however, the manufacturer's dissatisfaction with the marketing system has continued. We have seen that a high degree of specialization has developed and that the manufacturer has centered his attention more and more upon production. This has resulted, among other things, in many new and improved products. The manufacturer would be well content to continue such a policy if it were not for one thing. He finds that he cannot dispose of his output satisfactorily and without friction through the regular channels. The wholesaler is reluctant to enlarge his already extensive stock and is unwilling to stock a new product or an improved product if his warehouse is supplied with similar articles. His reason is two-fold, he wants to dispose of the stock he already has without loss, and he does not want to load up with goods that may not appeal to his customers. The manufacturer is thus compelled to look elsewhere for an outlet for his product.

A somewhat paradoxical situation is now apparent in that increased inter-industrial specialization seems to set up conditions under which specialization breaks down to some extent. The manufacturer can no longer center his attention on production but is forced to take cognizance of selling problems.

Advertising as Weapon

The growth of national advertising in the past twenty years has afforded the manufacturer a weapon of considerable importance in his emergency. It has proved itself, however, to be somewhat retroactive in its effects at times. The manufacturer who has made use of it has frequently found himself in the position of the unprogressive retailer who refused to advertise because he had tried it once and found it brought him so much trade that his stock was all sold out in half a day. He didn't propose to be sold out that way again. The manufacturer may not find that he has not the necessary stock, although that has occurred, but he frequently finds that his stock is not in the right place to enable him to cash in on the demand. This was often the case in the earlier days when advertising was made use of rather blindly as a means to compel dealers to stock the product.

It has been found necessary to make a wiser use of advertising. An interest in the product has first been awakened through the agency of specialty sales-

men who have been sent out to do "missionary" work in advance. Then it has usually been possible to induce dealers to stock a small amount of the commodity so that an intensive campaign of advertising may follow and full advantage be taken of it. Thereafter the wholesaler has been more willing to stock the new product.

Contentions of Manufacturer

The success of the manufacturer has not been entirely satisfactory to him, however, and has in itself become the source of a further and more serious cleavage between wholesaler and manufacturer. The latter has not forgotten the refusal of the wholesaler to handle his product originally and his reluctance to stock it even after the advertising campaign was under way. Besides he has frequently had to use his specialty salesman to get orders from retailers which have been turned over to the wholesaler to be filled. The wholesaler has often refused to buy more than just enough stock to fill these orders and has frequently rejected some of the orders thus turned over to him. In addition he has demanded his regular percentage for handling all of these goods, while the manufacturer has contended that a much smaller margin should yield a profit in view of the fact that he, the producer, has performed the major part of the selling function. The wholesaler has frequently been accused of filling orders turned in by specialty salesmen with substitute goods, perhaps with his own private brand, and in any case of computing his costs on such a basis that the manufacturer has really been paying for more than he received when charged the regular margin.

The wholesaler has defended himself vigorously against these various charges. He claims that he cannot fill his warehouse with goods for which there may be no continued demand and hence he will not buy until he is reasonably certain that a demand will be forthcoming. He objects to specialty salesmen and to filling all of their orders on the grounds that they come into his territory and "load up" the retail trade indiscriminately.

Wholesaler's Reply

Furthermore, they are unacquainted with the individual retailers and frequently take orders from some who are poor credit risks. The jobber sees no reason why he should buy new goods to fill such orders when he refuses to sell such customers on any but a cash

basis. As far as substitution is concerned it is not likely that many jobbers make a deliberate practice of such a policy. On the other hand it is true that many of the larger wholesalers have their own private brands and push them in competition with nationally advertised goods, but the wholesaler claims that he is forced to this line of action by the unprofitableness of the nationally known products. He further claims that his margin of mark-up is very small, and that the manufacturer has no right to expect him to handle his goods on a lower percentage.

The controversy has continued and the cleavage has become more and more distinct. The manufacturer may decide that, since he bears the main brunt of selling his product he can assume the other expenses involved in marketing and so eliminate the wholesaler altogether. The wholesaler in turn may decide to refuse to handle any nationally known products, and to devote all his attention to his own private brands. He may, indeed, embark in manufacturing these brands for himself. These two tendencies mark the development of integration and the breaking down of "inter-distributive" specialization, stimulated, as previously pointed out, by the expansion of specialization. The resultant product is in either case a large hybrid organization which manufactures and sells its own products directly to the retailer. The only distinguishing mark is often the name which frequently reflects the original character of the business.* The so-called "national" wholesale grocers are thus seen to have been eliminated from the class of middlemen and to have virtually become manufacturers as an outgrowth of their attitude toward national advertisers and their emphasis on private brands.

Sectional Wholesalers

But sectional wholesale grocers still make active use of private brands in competition with nationally advertised goods and have given manufacturers no little concern on that score. It is the sectional wholesalers whom the producers have chiefly in mind when they talk of eliminating the wholesaler and it is towards their elimination that most of the attempts at direct selling have been aimed. The producer is much less

* National wholesalers go under the title of wholesale grocers although they actually combine manufacturing and wholesaling. The known cases of such distributors are very few, F. H. Leggett and Co., N. Y., and Reid, Murdock & Co., Chicago, being outstanding firms. It is of interest to note, that the latter firm advertises that its "Monarch" brand is sold only through individually owned retail stores.

hostile towards the local jobbers who usually do not compete with private brands against nationally known products to anything like the extent practiced by the larger wholesalers. A noticeable tendency towards an increase in the number of local jobbers in recent years,* while fostered chiefly by expansion of transportation facilities, and by the recent hand-to-mouth buying habit, has undoubtedly been aided by the attitude of national advertisers. The manufacturers feel that, though they may not get all the sales effort they want from local jobbers, they at least do not have to contend with competition from private brands. On the contrary local jobbers frequently push nationally known products in vigorous competition with private branded goods of larger wholesalers.

As a consequence of private brand competition, and the wholesaler's resistance to national advertising and specialty salesmen, an attitude of mind has developed between manufacturers and wholesalers which is surcharged with hostility. Open rupture has taken place, however, in relatively few cases. While some manufacturers have eliminated the wholesaler with apparent success, others have made the attempt only to find a complete break more disastrous than a continuation of the old system. In a greater number of instances direct selling has been attempted in certain restricted areas, mainly large metropolitan centers of population, while the wholesaler has been utilized to reach other territories. In view of the attitude of many manufacturers toward the wholesaler the question naturally arises why has there not been a greater shift to direct selling? The answer probably lies in the problem of cost.

Question of Costs

In the first place it is a desire to reduce costs of production which actually lies behind the whole question of cleavage between manufacturer and wholesaler. To reduce production costs a large and steady market is essential. Realizing this fact the manufacturer's old unconcern as to what became of his product once it left his hands has vanished and in its place is a very keen interest in the course it follows until the final consumer is satisfied. Com-

petition has made it imperative that a large market be secured and maintained if production economies were to be maximized and costs reduced to a minimum. Hence maintenance of the market has become the manufacturer's cry. But maintenance of the market has become a costly process, and the typical manufacturer may well find himself in the paradoxical position of increasing his costs of distribution in an effort to reduce his costs of production. Competition has apparently driven him to this point and competition may be expected to continue to drive until both sets of costs are reduced. When the ultimate effects of competitive forces dominate the situation, as they inevitably must, the cheapest means of getting the goods to the consumer will triumph.

Direct selling has not proved to be as economical a means of distribution as is that which the wholesaler provides. Hence it would appear that the latter must eventually win out over the manufacturer in the contest for the performance of the wholesale functions.

Manufacturer's Costs

An examination of actual costs involved by both groups of competitors would be enlightening, but very few statistics on this point are to be found. However, one recent study of marketing costs of manufacturers of grocery products throws some light upon this problem.* While the extent of the survey is decidedly limited, only 72 manufacturers being included, some tentative deductions can be made from the data. The aggregate sales of the 72 firms amounted to \$690,803,862. Nearly two-thirds of the firms sold on a national basis. Thirty-six of them "sold, at least to some extent, to unit retailers", 28 sold only to wholesalers and chains. It would be interesting and instructive if more definite information were available on this point, the extent of direct selling to retailers. It can only be conjectured, of course, but the experience of the writer leads him to conclude that this number can be accounted for largely by the flour millers and meat packers, who customarily sell to retailers directly, especially to the financially strong ones; and by cracker and cereal manufacturers; and by dealers in coffees, teas and spices. In most of the latter cases direct selling is typical due to the nature of the

products all of which deteriorate with age. Some of the direct selling may be attributed to national distributors, many of whom have experimented with such practice in metropolitan areas, but most of it is no doubt confined to producers operating in territories of less than national scope.

The Harvard Study

Chart III which has been prepared from the data of the report is a summary of the figures obtained from 62 manufacturers in five groups.* This number is far too small to constitute even a "sample" of the whole field and hence lends itself only to the most tentative of conclusions. But, to quote from the general summary of this Harvard Bulletin* "the significant question is not whether total marketing expense is 19.5% or 20% for example, . . . but rather whether it most closely approximates 10, 15, 20 or 40%." Bearing our limitations in mind it is interesting to note that total marketing expense to manufacturers (Chart III) is about twice as great as total expense to wholesalers (Chart IV.) and approximately 16% greater than total expense to retailers (Chart V). Looked at in another way marketing expense on the part of the average retailer, exclusive of profit, accounts for 18c of the consumer's dollar, while that of the wholesaler accounts for only 9c and the manufacturer for about 15c.

If Chart III can be used at all in an analysis of the relative cost position of manufacturer and wholesaler it serves to substantiate a priori deductions as to the superiorities of the latter. If it costs the average manufacturer in the neighborhood of 20% of net sales to market his product very largely to a relatively few wholesale outlets† his disadvantage in shifting to direct selling to retailers becomes quite apparent‡. Nearly a third of this total cost is incurred for his sales force which would have to be enlarged many times to cover the entire retail field as intensively as the wholesale grocer now cultivates it.

* Meat Packers; Canners; Coffee, Tea, Chocolate and Spices; Cereals, Crackers, Macaroni, Salt, Preserves; Soaps, Cleansers, Polishes and Disinfectants.

* Bulletin No. 77, Harvard Bureau of Business Research. Page 1.

† Even on a national scale there would be but some six thousand of such outlets. See Chart II.

‡ Grimes, J. F. in a Bulletin of the National Wholesale Grocers' Association for July, 1925, estimates the retail food outlets numbered 570,114 of which 327,212 were retail grocery stores.

* "The grocery field has already experienced the national trend toward localization to the point where there is hardly a city of 2,500 or over which has any sort of surrounding trade territory that does not have a wholesale grocery dealing in staples." Commercial Survey of the Southeast, U. S. Department of Commerce. Domestic Commerce Series, No. 19, 1927. Page 165.

* "Marketing Expenses of Grocery Manufacturers for 1927." Bulletin No. 77, Bureau of Business Research, Harvard University. Oct., 1928.

Chart III.

Marketing Expense of 62 Grocery Manufacturers, 1927*

Net Sales — 100%

	% of Net Sales
1. Sales Force Expense and Brokerage (from ½% to 2%).....	6.6
2. Total Sales Promotion and Advertising Expense.....	5.02
3. Total Shipping, Transportation, Warehouse, Delivery Expense.....	5.76
4. Losses from Bad Debts.....	0.16
5. Credit and Collection Expense (Except Administrative).....	0.04
6. Marketing Administrative Expense.....	3.54
7. TOTAL MARKETING EXPENSE.....	21.12

* Data taken from Bulletin No. 77. Harvard Bureau of Business Research, October, 1928.

Chart IV.

Operating Expenses for 501 Wholesale Grocers, 1923*

Net Sales — 100%

	% of Net Sales
1. Sales Force Expense.....	2.6
2. Advertising and Other Selling Expense.....	0.15
3. Total Receiving and Shipping.....	2.15
4. Total Executive and Office Salaries and Expense.....	2.42
5. Rent.....	0.50
6. Heat, Light, etc. Taxes, Insurance, Repairs and Depreciation.....	0.64
7. Total Interest.....	1.50
8. Miscellaneous Expense.....	0.20
9. Losses from Bad Debts.....	0.40
10. TOTAL EXPENSE.....	10.60

* Data taken from Bulletin No. 40, Harvard Bureau of Business Research, 1923.

Chart V.

Operating Expenses for 545 Retail Grocers, 1924*

Net Sales — 100%

	Common Figure % of Net Sales
1. Total Salaries and Wages.....	10.90
2. Advertising.....	0.35
3. Wrapping, Delivery, Office Supplies.....	2.00
4. Rent.....	1.30
5. Heat, Light, etc. Taxes, Insurance, Repairs, Depreciation.....	1.15
6. Total Interest.....	1.10
7. Miscellaneous Expense.....	0.80
8. Losses from Bad Debts.....	0.40
9. TOTAL EXPENSE.....	18.00

* Data taken from Harvard Bureau of Business Research, Bulletin No. 52, 1924.

Possible Costs

Granting that a figure approximating 5% of net sales* fairly measures manufacturer's present selling costs it is a very conservative estimate to impute 20% to such expense if direct selling were undertaken.* Not only would a much greater sales force be needed on

* The figure in Chart III for Sales Force and Brokerage corrected for average brokerage expenses (6.6%—1.5%) gives a figure of 5.1% for sales force expense.

* It is assumed that the increased sales force is necessary to maintain the status quo of sales under indirect selling. If sales could be greatly increased this figure would be correspondingly reduced.

account of the greater number of dealers but also because of the greatly increased number of calls that would be required. Manufacturer's salesmen seldom call as frequently as once per month on their wholesale accounts and calls as infrequent as once or twice a year are not uncommon. Wholesalers on the other hand, send their representatives out each week in a majority of cases and calls as far apart as once a month represent about the maximum of infrequency found in that trade. Hence on the score of increased sales force expense, alone, and that most

conservatively estimated, the manufacturer's total marketing expense would rise to a figure approximately 50% in excess of present combined marketing costs of manufacturers and wholesalers. But this is surely not the only point at which the manufacturer's costs would be increased by direct selling. The third item in Chart III would be affected. A large share of the present sales must be in wholesale quantities of car-load lots. Under a system of direct selling the bulk of the shipments would be for less than car-load lots which would mean a considerable increase in transportation and shipping charges. Again, much of the present selling to wholesalers takes place as rapidly as the product is manufactured, little warehousing being required. Retailers could hardly be expected to order in much larger quantities from manufacturers than they do now from wholesalers. Neither could they be expected to order much less frequently. As a result the manufacturer would have to furnish the warehouse space now provided by the wholesaler which would further tend to increase his marketing costs.

Larger Credit Losses

On the score of losses from bad debts it would likewise appear that an inevitable increase would ensue. Wholesalers, who are in close touch with the credit standing of retailers in a much more restricted area than could be possible for manufacturers, show a figure of 0.4% of net sales on this account. The manufacturer could not be expected to show a lower figure than that, and might well incur a greater percentage of loss. Also his credit and collection expenses would be greatly increased due to the larger number of accounts he would have to handle. This latter fact would contribute toward higher administrative expenses as well.

A conservative estimate of the marketing costs to manufacturers under conditions of direct selling would thus be closer to 40% of net sales than to the tentative figure of about 20% under present conditions. The wholesaler's operating costs on the other hand are but 10% approximately, of net sales. This advantageous position of the latter derives, as we have seen, from two general conditions. His field of operations is so narrow that he can work it much more intensively than would usually be possible for the manufacturer; and he handles several thousand different articles and sizes in contrast to the dozen or so of the average manu-

facturer. On the basis of the first consideration his risks of doing business are greatly lessened, and as a result of the second his operating costs of doing business per item handled are greatly reduced. In brief, the wholesale grocer is a specialist in distribution and his superiority rests upon the foundation of the efficiencies of specialization. It must be maintained, then, that the manufacturer must bow to the wholesaler, on the score of economy.

Accepted by Manufacturers

Manufacturers generally have recognized this fact and those who do sell direct or contemplate direct selling have endeavored to reduce selling costs as far as possible by resort to various expedients. Two of the methods commonly considered may be mentioned. In efforts to reduce selling costs a larger line of products may be developed by an individual manufacturer in the hope of reducing the cost per item, or several independent producers may unite in a merger which also increases the line of items handled and may even develop additional marketing economies. Whether or not one of these methods will be adopted to reduce expenses of marketing or whether the wholesaler will survive as the manufacturer's marketing outlet is an important problem to both manufacturer and wholesaler.

As long as the wholesaler is able to maintain his cost advantage and as long as gaining and holding a large, steady market is the important element in the marketing problem of the manufacturer which it now is, there is bound to be a conflict, a clash of these opposing forces. But the "economy" aspect of distribution must come more and more to the front as competition develops. Each manufacturer will then have to face squarely these two alternatives. He must either accept the wholesaler or he must attempt to reduce expenses of direct selling to a competitive basis either through increasing his line or by joining with other manufacturers for cooperative sales advantages.

Explains Mergers

There is some evidence that manufacturers favor the latter alternative and are bending their efforts toward the end of reducing selling costs through both increasing their lines and forming mergers. There are several interesting developments now in progress. The Heinz Preserving Company of Pittsburgh with "57" varieties may be cited as the classic illustration of a firm sell-

ing direct and maintaining a relatively large line of products. Another example in this direction was furnished the writer confidentially by one of the general sales executives of a nationally known food products firm. The frequent appearance of new items in an already quite extensive line and particularly that of an article quite unrelated in nature to the other products had been noticed. These observations were mentioned to the executive and he was asked when his company was planning to eliminate the wholesaler. He admitted that they had that objective in mind and had taken over direct selling in certain metropolitan areas. The new product proved to be one of a semi-perishable nature which is normally sold direct and was to be used to secure retail contacts.

An illustration of the tendency towards mergers in the food industry is found in the case of a nationally known cereal manufacturing corporation which has been extending its holdings in divergent directions, buying up control in companies which manufacture non-competing prepared food products. It is contended by some that direct selling of these allied products will eventually be effected. As an opening wedge, control over a salad dressing producing company has been secured.* Contact thus established with retailers throughout the country can be utilized for the direct sale of a large list of nationally known products which are being brought under the control of this gigantic corporation, sometimes called the "General Motors" of the food products industry.

Not For the Many

While such instances do represent a tendency among manufacturers which may eventually be worked out by a relatively few powerful concerns, they should not be given undue weight. The vast majority of small producers of food products can never hope to achieve this end and must rely on the wholesaler for their outlet. Furthermore, efforts to reduce selling costs by increasing the line of products ignores the economies of large scale production which generally result from the concentration of efforts on a small number of highly standardized articles. To extend the line of products in the individual plant

* Salad dressing is of such perishable nature that it is frequently sold directly to retailers by the manufacturer.

is to reduce productive efficiency. Hence the gain due to increased marketing efficiency may be more than offset by the loss in productive efficiency.

This effort to reduce selling expenses, however, is also at the root of such a persistent trend toward concentration or mergers in the food industry that a further examination of the basic problems involved in combination is incumbent upon the student of food marketing. We find here an illustration of the characteristic tendency of modern American business toward that ever larger scale of enterprise concurrent with consolidations of both horizontal and vertical types. To gauge the possible extent and success of this movement involves a comprehensive evaluation of the fundamental assumptions which underlie it. Such a task cannot be avoided since the permanence of the wholesaler's source of supply, the independent manufacturer, and hence the survival of the wholesaler himself is implicated in the findings.

"Harbor of Monopoly"

As already noted one of the basic reasons for consolidation in the food industry lies in the assumption that marketing expenses can be reduced, while at the same time a stronger hold can be established over the market. This assumption, at least in so far as it applies to economy, rests upon the commonly held belief that expansion must result in the accrualment of those benefits imputable to large-scale combination.* A second basis is found to lie in that tacit yearning for the harbor of monopoly which the stormy sea of competition is so prone to engender in the hearts of business men, and towards which consolidation inevitably points.

The first assumption upon which the trend towards consolidation is based, namely that such organization must entail the gains from large-scale combination is open to serious criticism. For one thing it rests upon the common belief that the real gains of large-scale production are of general applicability and that mere increase in size will bring advantages in the way of greater productive efficiency. On this point Professor Dewing writes:

"Economies are inevitable as the business increases in size. These economies are, specifically, different in different businesses, but in general are connected with those parts of the busi-

* By large-scale combination, I shall have reference to both vertical and horizontal integration.

ness which are not concerned with personal judgment or individual skill and attention to detail. The economies are incidental to the automatic phases of the business. On the other hand, as the business enlarges certain wastes creep in which increase with greater rapidity than do the economies. These wastes, in contrast to the economies, pertain to all phases of the business where personal skill is required. The critical point in the expansion of any business is reached when the wastes incident to mere size overcome the economies. . . . The control of this law over business enterprise is absolute, notwithstanding the fact that its concrete application in a given case is vague and inexact.* Again he says, "... the industrial consolidations based on the fundamental presumption of the economies of large-scale production, were a profound disappointment to the student of economics and the practical business man alike."†

This opinion was based not only upon deductive conclusions but also upon a statistical investigation which corroborated the a priori view.‡ In this connection it is further interesting to note that within each of the six groups of grocery producers included in the marketing expense survey previously mentioned§ there is a direct correlation between size of sales and total marketing costs and between sales and each element of marketing cost. The following table, Chart VI, shows this relationship for total costs, and indicates that such costs vary directly with scale of operations. For example, firms in Group I with sales of \$4,000,000 show costs of 4.06% while those with sales of \$7,500,000 show costs of 7.21%.

But the development of mergers on the part of grocery producers involves more than mere large-scale production. The closely related problems of horizontal and of vertical or integrated combination are also present. Hence a full understanding of this phase of our study must include an investigation of the advantages and limitations respectively of large-scale enterprise per se, of unified or horizontally combined industry, and of vertical intergration.

Large Scale Production

The general advantages of large-scale production are usually enumerated as, (a) augmenting the possibilities of inter-industrial specialization, especially of fixed capital such as is embodied in machinery; (b) the creating of economies through a more complete use of all factors; (c) the utilization of waste through producing by-products, (d) the increasing of marketing economies from both the buying and selling sides.*

Horizontal combination is held to bring additional advantages such as the fuller utilization of the most efficient methods and machines developed in any one of the merging concerns, and the reduction of transportation charges through filling orders from the nearest source. Vertical combination is further credited with a greater reduction of marketing costs by providing each step in the productive process down to the lowest with a sure and steady market for its output. It is also claimed that integration reduces risk and generally improves the efficiency of production by increasing the smoothness of all operations.

Opposed to this array of advantages are certain limitations upon the expan-

be checked by the fact that there is an optimum size of plant dictated by physical limitations in each particular industry. There is furthermore a point of minimum cost of production in each plant which is reached sooner or later as production is carried into the stage wherein output increases only at a diminishing rate. Operations can be profitably carried beyond this point only with a decrease in efficiency which nothing but a continually rising price for the product can justify. Finally in every industry there is a point beyond which production may not be carried, the point of maximum output. This is the ultimate limit of the expansion of production for beyond this point the quantity of product becomes actually less.

Human Element

Still another limiting factor lies in the human element involved in management. There is a limit to the capacity of even the greatest of our so-called "captains of industry". To attempt to expand beyond such power to manage properly must certainly result in reduced efficiency. Elaborate systems of accounts, checks and balances are usually designed to take the place of the personal supervision of the independent entrepreneur in smaller sized organizations. Such systems, however, are apt to become drags on the initiative of the employees with retardment of progress a resultant.

In addition to these generally recognized limits to large-scale production it seems to the writer that the list of commonly accepted advantages is open to no little criticism. The primary advantage of those listed above, namely a fuller realization of the principle of specialization within an industry can readily be assented to as a gain to be derived from large-scale enterprise. This is true because large-scale enterprise is itself conditioned upon the essential prerequisite to the extension of the principle of specialization, that is a wider market for the product. It is noteworthy, however, that this increased specialization is generally recognized as being of greater importance in the case of fixed capital in the form of machinery, and valuable but only in a lesser degree in the case of labor itself. Large-scale enterprise no doubt introduces greater subdivision of function in the case of labor but the great gains come from the reduction of such functions to simplified processes easily adaptable to the use of machines. It is the development of machinery that

Chart VI.
Comparison of Total Marketing Costs with Sales in
Six Groups of Grocery Producing Firms*

Group Number	Sales		Marketing Costs % of Net Sales	
	(a)	(b)	(a)	(b)
I.	\$ 4,000,000	\$ 7,500,000	5.06	7.21
II.	12,000,000	35,000,000	4.99	9.14
III.	725,000	2,000,000	15.42	19.64
IV.	500,000	950,000	15.83	20.46
V.	425,000	10,000,000	23.69	29.76
VI.	150,000	300,000	30.63	47.87

* Harvard Bureau of Business Research, Bulletin No. 77, 1928.

* Dewing, A. S. "Financial Policy of Corporations." Ronald Press, 1926. pp. 661-2.

† Ibid. Page 655.

‡ Dewing, A. S. Quarterly Journal of Economics. November, 1921.

§ Harvard Bureau of Business Research, Bulletin No. 77, 1928. The six groups are those enumerated on page 46, Note No. 1, and in addition a group of flour millers omitted from the earlier discussion.

sion of large-scale enterprise and combination. After a certain point has been reached the expansion of industry must

* Taylor, F. M. "Principles of Economics," Chapter VII. Marshall, A. "Economics of Industry," Book IV. Chapter XI. Taussig, F. W. "Principles of Economics," Chapter IV. Haney, L. H. "Business Organization and Combination."

reduces the powers of nature to a state of servitude for man and enables him to accomplish what would be impossible to his unaided strength.

Some Limitations

In so far, then, as a large organization may develop and fully utilize equipment which might prove to be initially too expensive and show ultimately too many unused utilities for the small-scale operator, decided advantages may accrue to the former on the score of greater specialization of capital. That this is not a universal advantage to the larger industry, however, has been pointed out by Alfred Marshall* who noted that there is frequently an optimum size, not only of plant but of machinery as well, which is not beyond the reach of the average small-scale producer. In such cases the only distinction lies in the greater number of plants or of machines which the extension of scale of operations permits to the large-scale industrialist. Some advantages, nevertheless, clearly accrue to the latter both from greater division of labor and greater specialization of capital although probably less than the usual unqualified statement implies.

The second advantage claimed for large-scale business, a more complete use of all specialized factors, clearly calls for little comment. Where a small-scale producer may have to use a skilled man on unskilled tasks or a machine especially designed to do one job upon work for which it is not best adapted simply because he lacks sufficient specialized opportunities to keep either man or machine completely busy, the larger operator would be more likely to employ fully not one but many skilled men and specialized machines. Thus no inconsiderable advantage would tend to fall to the lot of the latter.

Use of By-Products

But with the other advantages usually imputed to large-scale production considerably more qualification seems to be necessary. This statement is particularly true of the gain held to derive from the elimination of waste through the manufacture of by-products. The large-scale producer, it is urged, has such large quantities of residual materials adaptable to the manufacture of various commodities that enormous waste is transmuted into profitable income through the simple expedient of

processing these waste materials. The argument rests upon the assumption that the inevitable residuum would of necessity become not only waste materials but frequently additional source of expense as a result of the need for removing or disposing of it. This argument is supported by the fact that many manufacturers have actually allowed valuable materials to go to waste and have gone to considerable expense in disposing of them. But this was merely because no use had yet been discovered for such substances.*

Once profitable uses are known for by-products the ones responsible for their appearance should experience no further difficulty in disposing of them to advantage. This holds true for the small-scale entrepreneur as well as for the larger operator. In fact, it might well prove to be more advantageous to the larger scale producer to sell his incidental materials than to process them himself since the latter policy would entail an extension of his line with accompanying departure from the specialized production of a few highly standardized products. The latter policy is the more characteristic of our successful large-scale industries and although many of them have taken over the processing of their own by-products it may be argued that their continued success has been in spite of such action rather than as a result of it. The presumption would be that an independent specialist in the processing of a particular by-product would be more efficient than a producer who looked upon it as a mere side line.

Research Advantage

The large-scale producer may find some slight advantage because of his ability to maintain a research department capable of developing new uses for his residual factors, but even so it is not essential that such uses be carried into the production stage by the discoverer. Hence it must be concluded that much less weight can be given to

* An illustration of this point may be found in the lumber industry of the Pacific Northwest. Every large lumber plant was confronted with the problem of disposing of sawdust. This was usually met by the construction of huge burners, great towers of masonry with screened in tops. Disposal of sawdust and waste lumber in this fashion is said to have cost the mills on an average of \$10 per day. A recent news item in the *Christian Science Monitor*, January, 17, 1929, page 4, comments on this fact in discussing the introduction of the new "hogged" fuel and sawdust burner as a practical heating device. The waste material is now netting the mills from \$100 to \$150 per day.

the third alleged advantage of large-scale production than is usually done.*

Under the fourth heading, too, we find reason to question the generally accepted position since the marketing advantages claimed for the large-scale operator over his smaller rival diminish upon careful examination. It is urged that the large-scale operator, through buying in large quantities, gets much better prices than would be possible for the small producer with his limited buying capacity. To determine how much weight can be given to this contention it is necessary to examine the nature of manufacturer's purchasing. We can leave fixed capital purchases out of consideration since this argument is used only with respect to investments in circulating capital, so-called. Such investments of the average manufacturer can be classified under the three categories of expenditures for labor, raw materials and supplies, the latter consisting of such items as coal, lubricating oil, electricity, etc. In the case of labor there is no particular advantage that can accrue to the producer on account of size alone. If other conditions are the same wages will tend to be about the same in a large plant as in a small. Certainly no one will claim that a man can get his labor more cheaply simply because he hires more of it* Any gain on this score comes under savings from fuller utilization of labor services.

Regarding Raw Materials

Neither in the case of raw materials can it be maintained that the advantage is all on the side of the large-scale producer. Take for example the flour milling trade. The raw material here, wheat, is a highly standardized product most of which is marketed through or-

* The effort to extend the line of products not only on account of reducing marketing expense but also because of a desire to utilize left-over materials has been noticeable in many large food products industries such as Van Camp's Packing Company, Campbell's, Snider's and others. The results have not always been satisfactory. Most of these firms have won their reputation on one product have subsequently tried to market additional products on the strength of their reputation in the outstanding article—the policy of "full line forcing". The public, however, has been reluctant to accept many of these new articles. There is an insistent demand for Van Camp's Beans, Campbell's Soups and Snider's Catsup, but Van Camp's Catsup and Snider's Soups and Campbell's Beans have not met with the same general response. It might well prove more profitable to arrange for the disposal of residual factors to other specialized producers.

* In fact, workers frequently prefer to remain with small-scale plants, where they find a greater degree of individuality possible, than to shift to larger concerns where they are but inconspicuous cogs, even though some slight wage difference in favor of the latter exists.

* Alfred Marshall "Economics of Industry," Book IV. Chapter XI.

ganized exchanges. The price is a matter of common knowledge and neither large nor small-scale producer could look for concessions. In fact it may be defended that the large-scale operator would usually have to buy his raw materials from standardized markets and responsible producers in order to insure an adequate supply, whereas the small-scale competitor, requiring smaller quantities would be in a position to shop around and might frequently buy up job lots at very advantageous prices*. Again, while it would be generally true that a buyer in larger quantities would get a quantity discount made possible by reduced costs of filling a large order, and reduced transportation charges, no great advantage could be expected after orders had reached a minimum size of car-load lot quantities. Orders in excess of such amounts, total factory output excepted, could not effect very considerable reductions in cost of shipping, billing, etc., and transportation rates are at their minimum on car-load lots. The large-scale producer no doubt buys many of his supplies in such quantities whereas the small producer does not. But it would be a very small plant indeed that purchased none of its raw materials or supplies in car-load lots. Furthermore on those purchases made in smaller quantities the disadvantage of the buyer is more obvious than real. He usually buys from wholesale middlemen in such cases and these latter may very well have every buying advantage of the large-scale producer.* Competition between wholesalers insures that part of this advantage at least will go to the small buyer.

Another situation has been noted by Professor Hayes wherein the small-scale producer has been aided by the shift from the use of steam to electrical power. A small motor for each machine can be substituted for the elaborate steam plant and connecting system of belts and pulleys. Power can be purchased as needed from a central plant, thus obviating the necessity for large purchases of coal or other fuel and incidental operating supplies.†

Position in Selling

The superior position claimed for the large-scale producer on the score of selling is likewise open to some ques-

tion. In so far as the selling advantages lie in lower prices due to lower costs of production there can be no doubt that the larger firm is superior to the smaller. But it is often asserted that the advantage lies in a fuller utilization of highly specialized advertising and other selling agencies which results in reduced selling costs. This contention rests upon the assumption that all producers advertise their output and employ sales forces to help them get rid of it. The fact is that very few of the small scale operators either advertise or maintain sales forces. They dispose of their product to manufacturer's agents, brokers, or wholesalers and undergo little or no sales expense. The true picture may well show that the selling expense of the large producer exceeds the savings due to his other advantages.

This examination of the virtues and defects of large-scale production goes far toward supporting Professor Dewing's claim that, "There is nothing in large-scale production, taken alone, that is necessarily economical."* But large-scale production is seldom to be "taken alone". As it usually works out horizontal or vertical combination, or both, are involved. This is the case in the grocery producing trade, hence it becomes necessary to consider the advantages imputed to these two types of consolidation. These can all be resolved into the two general categories of furthering the gains due to large scale production and of reducing marketing expenses. The gains under the first category call for little additional discussion. Certain potential advantages arise from the fact that some of the consolidating firms have achieved superiorities in production technique that may be extended to all plants after the merger.

Can Be Overestimated

But there is danger of overestimating this advantage. Competitive producers are among the first to adopt the newest inventions and improved methods and, unless the utmost secrecy is maintained, it is difficult for a given plant to hold technical advantages for any great length of time. Another offsetting factor lies in the fact that the large combination actually does cling to outworn methods simply because the managers do not feel that they can scrap machinery and equipment as rapidly as new methods are developed.

Andrew Carnegie is said to have junked machinery that was barely used whenever a better devise was available while the opposite tendency has been noted on the part of consolidations. The latter feel that they must get their investment out of each machine if possible and are unwilling to write off equipment until the depreciation account justifies it. However, it must be admitted that a small potential gain may well accrue to those producers who unite in combinations of either the vertical or horizontal variety.

Under the second category, marketing gains, it is also probable that some additional advantage may result from consolidation. When like units are included transportation costs can be minimized, and when unlike units are integrated one serves as an outlet for the next higher one, thus reducing selling costs to some degree. But let us examine this marketing aspect closely. In the case of food producers who consolidate to achieve direct selling we have an illustration of horizontal combination, in so far as competing firms join the merger; and of vertical combination, in that the functions of wholesaling are added to those of manufacturing. By way of illustration let it be assumed that a group of grocery producers form a merger. Let the group include a milling concern, a cereal producing company, a sugar refinery, a fruit and vegetable cannery, and a firm manufacturing soaps and cleansers; all having attained national distribution, with concomitant large-scale production either in one or many strategically located plants. Let it further be assumed that this group of producers had all been selling through regular wholesale channels with average marketing costs approximating those listed in Chart III. Can it be expected that such a group of manufacturers will be able to accomplish much in the way of reduced marketing costs?

Manufacturer's Situation

It has already been shown that the individual manufacturer cannot hope to achieve direct selling without incurring such costs as would tend greatly to widen the marketing margin and presumably tend both to decrease profits to the manufacturer and increase prices to the consumer. By extending his line the single producer has possibilities of reducing his costs per unit of merchandise but probably not far enough to better his position very greatly. Whatever gain may be expected from this

* This point is noted by Hayes, H. G., "Our Economic System."

* Marshall, Alfred, noted this point in his "Principles of Economics," Book IV, Chapter XII, 1895.

† Hayes, H. G. "Our Economic System," Chapter III.

* Dewing, A. S. "Financial Policy of Corporations," 1926 Edition. Page 684.

direction may well be reduced, if not eliminated, by increased manufacturing cost resulting from a departure from the fundamental principle of standardized production, namely concentration of effort on one or a very few items.

In what manner could direct selling be established by our assumed merger and what results would probably follow? For one plan a central sales organization could be substituted for the five separate sales departments with general charge over sales and advertising. Direct selling on this basis would involve many difficulties and result in few gains. Some reduction in sales promotion and advertising expense might be looked for as well as slightly lowered administrative expense. But a much larger sales force would be required than any one of the companies had previously employed and very likely a larger sales force than the combined forces of the five companies. However, it is certain that the five firms could achieve direct selling on a lower cost as a merger than would be possible for them as separate organizations, although the total marketing cost might well be expected to be greater than the average marketing cost of selling by the indirect method.

Warehouse System

To avoid many of the difficulties of direct selling as just proposed such as those involved in a speedy allocation of orders to the proper manufacturing departments, and to reduce warehousing and transportation expenses it might prove desirable to establish warehouses throughout the nation to which products could be shipped in car-load lots and from which the various market areas could be more satisfactorily covered.* This would amount to a duplication of the wholesaler's facilities. A sales branch manager, salesmen, office force, and shipping, receiving and warehouse staffs would be required. An examination of Chart IV fails to show any item which could reasonably be expected to be reduced by the branch sales department. In fact it may be argued that several thousand such branches would involve the serious problem of efficient management for each branch, lack of which

* A substitute proposal would be to rent warehousing facilities from public or private warehouse companies. Under this proposal only an office would have to be maintained in each market area. Overhead might be reduced on this basis but lack of uniformity in warehousing facilities as now existent would prove a counteracting disadvantage.

† If sales increased in greater proportion than the sales force such a possibility would be realized.

Chart VII. Hypothetical Marketing Expenses of a Merger of Five Producers of Foodstuffs (Direct Selling) Net Sales — 100%

	% of Net Sales
1. Sales Force Expense	5.00
2. Total Sales Promotion and Advertising.....	5.00
3. Total Shipping, Transportation, Warehousing, Delivery.....	7.00
4. Total Credit, Collection, Losses from Bad Debts.....	.40
5. Marketing Administrative Expense.....	5.00
6. Rent (or Warehouses)	.50
7. Heat, Light, etc. Taxes, Insurance, Repairs, Depreciation.....	.60
8. Total Interest	1.50
9. Miscellaneous Expenses	.50
10. TOTAL MARKETING EXPENSE.....	25.50

might easily cause costs to exceed those of the average wholesaler. To be sure such an extension of intensive marketing would be expected to result in greatly increased sales which would offset the tendency for the ratio of sales force expense to increase and conceivably might reduce it.†

An hypothetical account of marketing expenses under direct selling through wholesale branches might show some saving over combined manufacturer's marketing costs and wholesaler's operating costs, granting that a considerable increase in sales volume ensued and that the wholesale branches could be operated on an approximately equal scale of efficiency with independent wholesalers. Chart VII affords an illustration of such an attempt. Assuming Chart III to be representative for the manufacturer in our hypothetical case and taking Chart IV as a fairly reliable picture of wholesale grocer's operating expenses, direct selling shows a net saving of about 6%. It is by no means certain, however, that sales volume would increase sufficiently to permit of such a low figure as 5% for sales force expense. Neither could it be expected that as high a degree of efficiency could be attained by the sales branches under the control of salaried managers, as would be typical of independent wholesalers since the former would be hampered by at least a minimum of "red tape".

Competitive Forces

It must still remain doubtful as to whether the consolidation of food producers can be expected to result in marketing economies over the present methods or not, with the presumption being against it. But there can be little doubt that the combining producers would be able to secure and maintain a firmer hold upon their market through

closer contact with it and more intensive cultivation of it. This advantage, however, could not become a permanent one unless accompanied by at least as economical distribution as competing producers were able to secure.

In view of the foregoing examination of the potential advantages of large-scale production and combinations of both the vertical and horizontal kind, it must be concluded that there is little danger of the wholesaler's source of supply, a group of independent manufacturers, being very speedily annihilated on the basis of the first assumption, namely the securing of marketing economies through consolidation. This conclusion rests upon the assumption of a continuance of competitive conditions in the food industry.

Possibility of Monopoly

But it may be that the desire to attain monopoly, the second basis for consolidation, will eventuate. While at present non-competnig firms in the main are the only ones involved in the food mergers it is not impossible to anticipate a situation in which all of the major producers of grocery products will be combined in a relatively few large groupings. With such a development it would be a comparatively easy step to reduce these groups through holding companies or other financial devices to a gigantic monopoly of food products. Such a result is highly improbable but not inconceivable. Should monopoly actually materialize it is probable that marketing costs could be reduced to a lower point at least than that shown in Chart VII, since great savings could be expected to follow the elimination of competitive selling and advertising costs, while the inclusion of the large number of items now handled by all of the major food producers would permit a considerable reduction

in sales cost per item. But whether or not direct selling would actually follow as the policy of such a monopoly cannot be determined in advance. If manufacturers maintained the unfriendly attitude towards wholesalers which some of them now hold, direct selling would probably result. There would at least be a greater danger to the wholesaler's position than now exists. The prospect of a monopoly in the food industry, however, is one that we scarcely need contemplate. The attitude of the public as expressed by the activities of the Federal Trade Commission in connection with the Meat Packers investigation resulting in the famous "Consent Decree" of 1920 gives us a clue as to what could be expected should such monopoly become imminent. It would hardly seem worth our while to consider such a remote eventuality further.

Some Conclusions

In conclusion we see that the manufacturer-wholesaler relationship is one in which conflicting forces are at work. The growth of specialization, bringing in its wake large-scale production, has

also set up counteracting tendencies in the direction of diminished inter-distributive specialization. Integration of the manufacturing-wholesaling functions has taken place in some instances, originating either with the manufacturers, or with the national wholesalers.

The manufacturer is torn between the necessity for gaining a large and steady market, and the desire for economical distribution. He wants both and in seeking to attain the dual result has attempted to combine the wholesaler's functions with his own. With a narrow line of products he finds direct marketing too expensive; with a larger line his costs of production tend to rise and may well offset his gains from more efficient distribution. He may consider consolidation with other manufacturers as a further alternative in hopes of securing the additional marketing advantages generally imputed to large-scale combination and with the possible desire of achieving monopoly in the end. His hopes in both of these latter directions are apt to prove largely unfounded. A close examination of the economies of large-scale combination fail to show any great potential reduc-

tion of marketing costs while monopoly may be ruled out on the grounds that the state would never permit it.*

The indirect method of marketing by way of the wholesaler seems to have an outstanding advantage on the score of economy. As long as this is true and as long as competition can be looked for among food processors the presumption is in favor of the permanence of the wholesaler. For a time the manufacturer's chief concern, which is for a steady market, may cause him to ignore the economy aspect. But with the development of keener price competition, economical distribution is bound to become the dominant consideration. When that time arrives the wholesaler must return to favor unless he has in the meantime been eliminated by forces from the other extreme of the marketing system. Of these forces the chain store bids fair to eliminate his outlet. The attack on the wholesalers position from this angle will next occupy our attention.

(To be continued)

* The enormous number of small producers would also make it difficult if not impossible as a practical measure.

Analyzes Threat of Chain Store and Retailer Cooperatives to Wholesale Grocer

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PART II. THE CHAIN STORE

The contemporary observer of marketing phenomena must be struck by the emergence and rapid development, during the past twenty years, of an entirely new type of rival to the regular marketing agencies. The revolutionary chain store method has become a strong competitor for the right to perform not only the wholesaler's functions but those as well of the manufacturer and of the retailer. The chain thus threatens at once to displace the wholesaler and both his source of supply and his marketing outlet. It is in the latter respect, however, that its competition has been most formidable.

A brief examination of the nature of this novel competitor for marketing honors may well prove of value as a basis for an understanding of the causes determinative of its current success and an estimate of the possible limitations upon its ultimate expansion. The typical grocery chain is composed of a large number of highly standardized retail units, a smaller group of warehouse or wholesale units, and occasionally of a number of manufacturing plants, all under the general control of a strongly centralized management. This closely articulated form of business organization embodies at once large-scale enterprise, unification or horizontal combination of coordinate units, and vertical combination or integration of sequential elements in the marketing chain. Unification is frequently discernable in several strata of the chain structure, one business showing coordinate retail outlets, wholesale units, manufacturing plants, and even primary producing sources such as farms or ranches.

Striking Parallels

The student of marketing is immediately impressed by the striking parallel which the chain store structure affords to that developed by the British

THE BULLETIN presents here the third installment of "Competitive Forces in the Wholesale Marketing of Prepared Food Products" by Nathanael Howard Engle, School of Business Administration, University of Michigan. Mr. Engle writes from a scientific viewpoint. In addition he has had the advantage of several years of practical experience in the food business.

The first installment appeared in the November issue of *THE BULLETIN* and included Mr. Engle's Introduction, Section I, "The Marketing Mechanism" and Section II, "The Wholesale Grocer and his Function". In the second installment Section III, "Competitors for the Wholesale Grocer's Office", was started. Part One—The Manufacturer—of Section III was completed in that issue. This issue presents Part Two, "The Chain Store", of Section III and also Part Three, "Co-operative Marketing".

Mr. Engle's study will be completed in a subsequent issue which will reproduce Section IV, "The Permanence of the Wholesale Grocer".

Editor's Note.

consumer's cooperatives. Both of these parallel cases, however, prove upon examination to be but species of a broader genus, namely that type of business consolidation so characteristic of American and German large-scale productive enterprise. The chain store system thus attempts to solve the problem of "mass distribution" by employing the business device developed by "mass production".

An examination of the chain store situation in the light and shadow respectively of the virtues and defects of the type of business organization which it illustrates is essential to an understanding of the probable outcome of the struggle for supremacy between the chain store and the wholesale grocer. Such an examination will be attempted, following a brief considera-

tion of the growth and present extent of chain grocery marketing in the United States.

The Beginning

George H. Hartford is credited with fathering the movement by establishing in the years preceeding the Civil War, what has since become the Great Atlantic & Pacific Tea Company. Other attempts were made at various times since then, but the important development must be limited to the past fifteen years, since the growth of the chain store idea has been particularly noticeable only since the World War. The exact extent of this movement is very hard to determine. It is estimated, however, that there were in 1914 about 500 grocery chains with a total of 8,000 retail outlets. These stores constituted about 3% of all grocery stores in operation in 1914 and are said to have handled about 5% of the total retail trade. * By 1927 the number of chains had increased to 800 and the number of stores to 57,000. The business credited to them had expanded to one-half of all sales in cities of 100,000 and larger and one-third of all sales in cities of 25,000 and larger. This amount of business would normally have required 3,200 wholesale grocers or 150,000 retail dealers.* The growth during the year 1928 is indicated by an estimate of 878 chains and 67,000 stores made by one authority † and a forecast made by investment advisors that six grocery chains will achieve sales of one-half of the total retail business in groceries in the year, 1928.‡

Some Estimates

Thomas' Register of Wholesale Grocers claims to list all chains of five or more retail grocery stores. A tabulation of the chains listed in the 1928 directory reveals but 482 with a total of 46,777 stores. Some additional light

* Cherington Paul T. "Chain Stores in the Grocery Business." *The J. Walter Thompson News Bulletin*, September, 1927. Also "The Progressive Grocer," Vol. IV, No. 4, April, 1925.

† Baxter, W. J. "Chain Store Distribution," Page 178, *Harpers*, 1928.

‡ Standard Trade and Securities Service, November 30, 1928 *Bulletins*.

is thrown on the problem by the study of "Retail and Wholesale Trade" made by the Domestic Commerce Department of the Chamber of Commerce of the United States in connection with the Bureau of the Census.* This study covers eleven cities which represent practically every section of the country. Retail grocery sales totaled one-half billion dollars in 1927 of which the chains controlled 41.3%. This percentage is probably too large for the entire country since the data is confined to urban areas. Professor Cherington's estimate of one-third of the business in cities of 25,000 or larger, no doubt, represents as close an approximation as is at present available, although this is probably a little too high for the entire country.

There are, moreover, some interesting statistics on the growth of chain store sales published in the Federal Reserve Bulletins. A comparison of the Indexes of Grocery sales for chains with those for wholesale grocers, Chart VIII, shows a continuous and rapid rate of increase in chain store sales since the depression of 1921. Wholesale grocer's sales, on the other hand, have shown a slight recovery between 1921 and 1924 and a slight decline since 1924 until last year when there was a barely perceptible improvement. The rate of increase in chain store sales was approximately 22% in 1925 over 1924, and about the same each year thereafter until 1928 when the figure fell to 20%.

Few Definite Facts

While reliable information is scarce regarding the growth of chain stores for the entire nation there are available a few studies of restricted areas which throw no little light upon this problem. Two investigations have been made of the Philadelphia market area, one of which included the third Federal Reserve District* and †. In Philadelphia, chain stores received an early start in the grocery trade and developed so rapidly that, by 1917 it is claimed that five chains were able to form a \$50,000,000 merger.‡ This growth continued until the chain stores numbered about one-third of the retail stores and handled about sixty per cent of the retail grocery business in 1925.*

* "Retail and Wholesale Trade," Chamber of Commerce of the United States, 1928.

* United States Department of Commerce, Domestic Commerce Series, No. 1, 1925.

† Abbott, W. L. "Competition and Combination in the Wholesale Grocery Trade in Philadelphia," University of Penn., 1920.

In view of the findings of these various studies the presumption is that the chain stores will soon dominate the grocery trade of the United States. Notwithstanding this weight of evidence to the contrary, however, there are persistent rumors afloat that grocery chains are rapidly nearing their saturation point. In the investment market, for example, the feeling is current that 1929 will show a greatly reduced rate of expansion in chain grocery growth.* On the other hand there are many who would not hesitate to say that there is no limit, that the chain principle must dominate the marketing system, and that the independent dealer is doomed. While such an outcome is not impossible it hardly seems plausible and certainly is not inevitable. On the contrary certain theories of limitation on chain store growth may well be advanced.

Natural Limitations

These limitations appear to the author to grow out of the very nature of those aspects of the chain to which its great success has been so generally imputed. The chain's success has been accredited to certain advantages in buying and certain economies in selling which have made possible reduced prices to consumers.† Let us first investigate the nature of those advantages which have been said to accrue to the chain because of large-scale purchasing. The author's thesis at this point is that the chain really has little or no power to surpass the independent merchants on the score of buying. Buying advantages, if existent, are outgrowths of that type of business organization which we have seen to be characteristic of the chain store movement. A defense of our thesis then must begin with an examination of the virtues and limitations of large-scale combination as applied to the marketing problem.

Our examination of the alleged gains of large-scale combination from the standpoint of manufacturing left us with the conclusion that such advantages were largely illusory. Some benefits, it is true, were seen to be derivable from increased specialization, particularly in the case of machines or fixed capital, and other gains were attributable to the fuller utilization of

specialized agents. Likewise, certain buying and selling economies were seen to be possible particularly in respect to horizontal and vertical combination.

What Are Advantages?

Now can it be maintained that even these relatively small gains will be realized by the typical grocery chain? In so far as the chains engage in manufacturing on a large scale it is presumable that most of these advantages will be earned. But this will give the chain system no net advantage over its rival since independent manufacturers, the wholesaler's source of supply, have the same benefits. The wholesale department of the chain cannot hope to receive its merchandise from its own manufacturing department on much better terms than the independent wholesaler can get similar commodities from other manufacturers. In fact, it is argued by Professor Dewing that the chain suffers a disadvantage in this respect.* Manufacturing, however, is still but a minor part of the average grocery chain's activities, hence the possibility of profiting from large-scale enterprise must be examined from the standpoint of the chain's major occupation, marketing.

From this point of view the first advantage, increased specializations, is of very limited applicability. The chief gain from this source came from the application of the principle to "fixed capital". In marketing "fixed capital" is a negligible element as compared with "circulating capital" in the form of merchandise. The optimum size of establishment is not one so large that a great amount of fixed capital is required. Neither is equipment of as great importance as labor in marketing activities. Only in so far, then, as the chain can hope to attain a greater specialization of labor per se can any net gain accrue under the head of the first advantage of large-scale industry. Subdivision of the labor function has already been carried quite far by the average independent wholesale grocer, whom we saw to have specialized buying, selling, receiving, warehousing, and shipping departments. In any event any further gain from this score cannot be held to be a monopoly

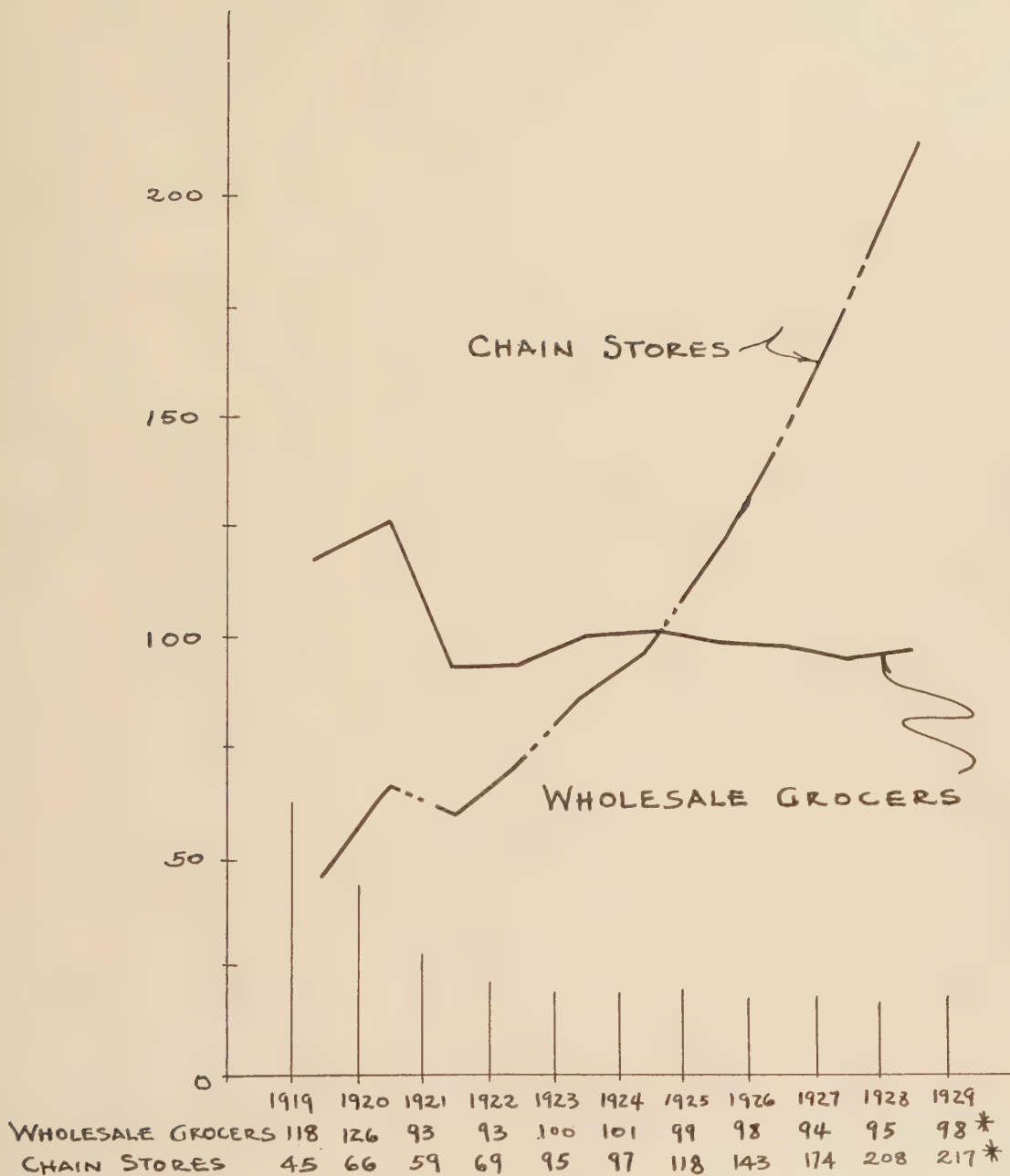
* Report on Chain Store Securities in Professor Rodkey's Investment Course, December, 1928. University of Michigan.

† Dewing, A. S. says, "It (the retail chain store) is based on the two fundamental assumptions, the economy of large-scale buying and the economy of standardized merchandising involving a minimum of special services rendered to the customer." "Financial Policy of Corporations," Page 693.

* Ibid, page 696. "Nowhere, however, are these weaknesses (of integration) so obvious as when integration is attempted by the chain store, for the simple reason that retail merchandising is a highly specialized business requiring unusual attention to its own detail and very different from production in any form."

• CHART • VIII •

INDEXES OF GROCERY SALES (1)
 (CORRECTED FOR SEASONALS)
 1923 - 1925 AVERAGE = 100



(1) DATA FROM FEDERAL RESERVE BULLETINS

* JANUARY ONLY.

of the chains. However, it may be true that in the retail trade some gain has accrued to the chain from further division of labor. If so it is more likely the result of increased standardization than of large-scale enterprise and hence may be adopted by the independent retailer.

Fuller Utilization

As a result of largeness of business, however, it is possible that the chain stands to gain on the score of the second advantage of large-scale production, a fuller utilization of some of the specialized agents. It is generally true that the average wholesaler lacks as definite an outlet as a chain's wholesale unit and that the former as a result would have to pay for utilities in its specialized agents which it could not fully utilize. The chain, on the contrary, could better adjust its specialized workers to tasks in such a way as to keep them continually occupied at their most efficient work. The writer believes that the chains may actually have achieved some results in this direction which are superior to those attained by the average independent merchant, but he would be inclined to argue that such gain was due to greater efficiency rather than to any inherent advantage of large-scale enterprise.

There remains only the slight advantage which we have seen may be credited to large-scale combination on the grounds of buying and selling economies. Aside from the doubtful advantage of integration arising from the chain's establishment of its own manufacturing department wherein does the chain have a superior position? We have noticed that no great advantage can be credited to large-scale purchasing after orders have reached a minimum of car-load lot quantities.

Single Qualification

This statement needs qualification only in case orders become large enough to include total factory output. In such cases general marketing expenses may be reduced enough to permit a considerable saving to the large buyer. Wherever the chain can purchase entire factory output it has a clear advantage over the average wholesaler. But on smaller purchases, provided always they are at least of car-lot size, the chain can not be said to have any great advantage over the average wholesale grocer.* The great bulk

of staple products handled are customarily purchased by wholesale dealers in car-lot minimums. Many other articles are purchased on the same basis by wholesalers in co-operation, the car being billed to one and "split" between them on arrival. In the case of many small factories or canneries with limited capacity the wholesaler frequently buys the entire output. There is also a noticeable tendency for competing wholesalers to combine over quite an extensive territory for purposes of achieving larger buying capacity. Hence it must be concluded that the chain has little or no inherent advantage on this count.

The chain has one advantage over the independents, however, derivable from horizontal combination of co-ordinate retail units. These outlets frequently extend over no inconsiderable area and it is not unlikely that goods not saleable in one section may be profitably diverted to stores in another part of the territory with less loss than a sacrifice sale would entail, and perhaps even with resulting profit

Buying Superiority

This summary of the advantages of large-scale enterprise, and of horizontal and vertical combination, as applied to chain store marketing fails to show any marked superiority of the chain from the standpoint of buying. What additional gains there are must also be qualified by the fact that large-scale enterprise has certain limitations of which Professor Taussig says, "The larger the scale of operations the more obvious the disadvantages."* These he finds in the increasing difficulty of large-scale management and the necessity for elaborate and expensive systems of control. A certain inflexibility and unwieldiness may well offset many of the gains. The actual facts regarding the buying advantages of the chain, while not inductively established as yet, may be further elucidated by a recent experience of the writer. While talking with one of the directors of a large grocery chain the subject of independent cash-and-carry wholesaling was brought up. The chain store executive took from his desk a current price list issued by such a wholesaler and informed the author that he had checked each item with his own prices and in every case the cash-and-carry wholesaler was selling at as low a figure as the chain's wholesale department charged its retail outlets.

If it be true that the much heralded buying advantages of the chains are not nearly as great as has been supposed it would seem that at least one theory of limitations on the chains has been indicated. If independent retailers can secure as low prices as chain retail outlets by turning to cash-and-carry wholesalers or similar organizations, they should be able to offer the chains a grade of competition that would at least tend to check the advance of the latter. But the selling economies of the chain must also be analyzed.

Two Cornerstones

It is from this angle that a second theory of limitations on chain store expansion may be advanced. In fact two closely related theories may be noted. It is the author's belief that most of the selling economies of the chains are the outgrowth of two of the chain's major policies, the standardized merchandizing of a relatively few staple products, and the cash-and-carry type of selling. In each of these policies the writer finds a check on chain store expansion. Some corroboration of the first proposition is found in the Philadelphia study made by the Department of Commerce investigators in which it was implied at least that a limit to the expansion of chain stores was to be found in the fact that chain stores specialize in staple or highly standardized products which leaves the independent dealer a chance to compete by handling specialties and fancy grocery products.* In fact the conclusion was that the chain stores are handling the bigger share of the staple product trade, in that territory, and that the independents must content themselves with the fancy grocery trade and such crumbs of the other trade as fall from the chain stores' table.

Such a theory as to the limitations of chain store merchandising is open to the criticism that it is based upon a superficial distinction between the chain stores and the independents. But there is no inherent condition in chain store marketing which dictates as an unalterable policy that only staple or standardized merchandise be handled. In fact a clear tendency toward the extension of line to include highly perishable products such as meats and fresh vegetables as well as fancy groceries is noticeable in the case of such chain systems as the Atlantic & Pacific

* The only exception is in the case of advertising allowances made by the manufacturer to the chain when a new product is introduced or sales stimulus is desired for an old one.

* "Principles of Economics," Chapter IV.

* Domestic Commerce Series No. 1, United States Department of Commerce, 1925.

Tea Company and the Kroger Baking Company.† No deep seated limitation on the extension of the chain system can be said to lie in a distinction based merely upon a transitory policy.

Operating Costs

A closer examination of this argument, however, reveals a more searching reason why the chain stores may after all find expansion hampered, at least, on this score. While it is undeniable that the chains may attempt to extend their line to include everything handled by the independent grocer and butcher the fact remains that their initial success has been closely identified with the standardized merchandising of standardized commodities, and any radical departure from that policy may be expected to increase the operating costs. It has only been by reducing store arrangement, equipment, and stock to a stereotyped system that it has been possible for the chain to solve one of its greatest problems, the securing of competent managers for the link stores at a low cost.

It is possible to reduce the human element of judgment to a minimum where non-perishable products constitute the stock. But in the case of perishable merchandise, a very large element of judgment is inevitably involved, and hence a distinct type of management is requisite.* This is true in two respects. The central buying department usually finds it inexpedient to purchase perishables hence the local manager has to act in the capacity of buyer from the nearest commission house.† This involves a distinct type of judgment as to quality and price of product and quantity that should be purchased. Furthermore, the care of perishable goods involves much more discrimination than is necessary for staple non-perishables. It thus follows that higher priced or skilled labor must be substituted for cheap unskilled help if the chain is to add these new items to its stock. The presumption is that the chains will find in this situation a

† Joseph M. Fly in a research letter from the Chain Store Research Bureau, December 19, 1928 is quoted as saying, "Increased growth or expansion through new fields such as the addition of fresh meats and vegetables cannot be materially looked for since nearly all chains are handling a large volume of fresh fruits and vegetables, and a majority of them already have meat markets, or will have them." The same bulletin gives statistics showing that the A. & P. system had 143 combined meat and grocery stores in the metropolitan district of New York in 1928.

* This point was suggested to the author by V. H. Pelz of the American Institute of Food Distribution.

† If there is a group of link stores in the same city a district buyer may perform this function.

serious stumbling block and one that must tend at least to increase their costs and hence weaken their competitive position.

Costs Compared

This presumption is borne out by what few figures there are available on chain store costs of doing business. Chart IX shows the average operating costs of two grocery chains in the Pacific States which the writer studied in 1926. Chart X shows figures for two of the most successful chains in the grocery business as given in W. J. Baxter's book, "Chain Store Distribution".* The latter chart shows total operating expenses of 15.7% and 16.04% respectively, an excess over the western figures which are 10.29%, partly explainable on the basis of higher wages and rents and partly due to the inclusion of warehouse and administration expense. In the same book figures are given for three combined meat and grocery selling chains. † The average figure shows total expenses of about 16% of net sales with a low of 10.75% and a high of 20.33%. The item wages, which does not exceed 7.4% in non-meat selling chains and is as low as 4.69% in the western chains averages over 9%, varying from 7.08% to 11.29%. Hence, if the extension of line to include perishable and fancy groceries thus tends to in-

Chart IX

Average Operating Expenses, Profits, Turnover, For Two Chains of 140 Cash-and-Carry Grocery Stores in the Pacific Northwest, 1926

Percentage of Sales. Net Sales—100% Three Months Average

1. Total Salaries	4.69
2. Advertising	0.98
3. Wrapping	0.24
4. Delivery	0.13
5. Rent	1.10
6. Heat, Light, etc	0.16
7. Taxes	0.17
8. Insurance	0.12
9. Repairs of Equipment	0.07
10. Depreciation of Equipment.....	0.32
11. Other Expenses	2.31
Total	10.29
Gross Margin	15.09
Net Profit	4.80

Stock Turnover 5.3 times in 3 months.

* Pages 191-192.

† Ibid. Page 194.

Chart X

Operating Costs for Two Successful Grocery Chains.*

	No. 1	No. 2
1. Net Profit on Sales.....	2.80.....	6.30
2. Gross Earnings	18.50.....	22.34
3. Operating Expenses	15.70.....	16.04
4. Advertising	.39.....	4.50
5. Salaries	7.40.....	7.70
6. Rent	2.07.....	1.70
7. Depreciation and Taxes 1.10.....	1.24	
8. Warehouse and Administrative Expense 3.02.....	2.31	
Turnover (times per year) 12.50.....	10.00	

crease costs, it must be concluded that there is at least a modicum of validity in the argument that the expansion of the chains may find a check in the character of the merchandise to which they are limited by the nature of their highly standardized methods.

Cash-and-Carry Limited

A second closely allied argument has been suggested which finds the boundary to chain store growth in the limit to consumer demand for cash-and-carry merchandising.* It has been pointed out that there has been a remarkable extension of credit and installment selling and an increasing demand for service in this country. As long as people demand service and credit, and there is no indication that such demand is falling off, there will be a place for the independent service grocer. The chain's business would consequently, seem to be limited to those who desire to pay cash and perform their own delivery service. This theory of limitations is open to the same criticism that was offered of the preceding theory, namely that the cash-and-carry distinction is but a superficial one. The chain store may and in some instances does extend credit and make deliveries, and the independent merchant may and occasionally does operate on a cash-and-carry basis entirely or provide a cash-and-carry department. Hence it cannot be maintained that herein lies the limit to chain store expansion.

But even here the argument cannot be dismissed too summarily. While it

* Baxter, W. J. "Chain Store Distribution," Page 191-192.

* This argument was suggested by Mr. F. D. Bristley, President of the Association of Grocery Specialty Manufacturers in a pamphlet published by that Association in 1925 and containing a reprint of his address to the Annual Convention of Grocery Chain Operators.

is true that the cash-and-carry distinction is not fundamental it must nevertheless be recognized as one of the chief practical distinctions between the policies of chain stores and those of independent stores. In 1920 the United States Department of Agriculture estimated that 81% of the chain stores of the country operated on a cash-and-carry basis, whereas only about 15% of all stores were characterized as cash-and-carry by the investigators.* Again, we have the definite statement of a practical chain grocery executive that

"Chains will remain cash-and-carry institutions and credit systems will rarely be adopted except in isolated cases where there exists public demand for weekly or monthly credit." †

Southeast as Example

Furthermore, it is admitted that the expansion of chain stores has actually been retarded in the Southeast because

"the volume of cash business and the peculiar local conditions were not favorable." "Representatives of national chain stores claim that they have found the lower coastal plain towns indifferent territory for the operation of their type of store, and that the cities through the center of the Cotton Belt are hardly more favorable because of the dependence on the growing of cotton and the comparative lack of consistent pay rolls." *

Again the fact that the chain stores have thus far confined their attention so largely to metropolitan centers that the saturation point is admittedly near at hand in the cities,† whereas very little headway has been made in the purely agricultural sections of the country affords some indication that the cash-and-carry policy is not only a fundamental chain store practice but already a limiting factor on the expansion of the chains.

* "Retail Marketing of Meats," Bulletin No. 1317, Department of Agriculture, 1925.

† Fly, Joseph M., President of National Chain Store Grocer's Association, 1928. Quotation from presidential address delivered in December, 1928. Chain Store Research Bureau's Letter, December 19, 1928.

* "Commercial Survey of the Southeast," United States Department of Commerce, Domestic Commerce Series, No. 19, 1927.

† Baxter, W. J. "Chain Distribution," Page 9 says, "the bulk of the 180,000-odd chain-store outlets are located in the Eastern part of the country, the center of concentrated population. Future expansion programs will largely concentrate on territory west of the Mississippi River and in the South."

Distribution of Incomes

Now, if it be assumed that the chains must continue on the cash-and-carry basis, there is certainly a real although indefinite limit to their growth. An examination of the distribution of incomes in the United States is enlightening on this point. From the study of the National Bureau of Economic Research ‡ we find that in 1918 over half of our income receivers got \$1500 per year or less, while nearly 40% received but \$1000 per year or less. Doubtless many of these people could pay cash for their groceries during times of prosperity but it must be admitted that few of them would be able to tide over even the briefest period of interrupted employment without the aid of a credit grocer. At the other extreme we have the receivers of very large incomes many of whom no doubt patronize cash-and-carry grocers but most of whom probably prefer the service-credit type of dealer.

In the intermediate group we find the bulk of the patrons of the cash-and-carry merchants but even here there must be many who make use of the service-credit grocer. The growing number of cases where both husband and wife are gainfully employed and hence too busy to shop for groceries constitutes one group which must have service credit. Another group out of the middle class is found in the great agricultural sections of the country where the major part of the income is received on a seasonal basis, following the marketing of the crops, rather than on a weekly or monthly scale. Under such conditions credit is an essential condition to the trade of the bulk of the farming population, and rather long term credit at that.

Estimate of Probabilities

On the whole perhaps no very definite line can be drawn since the demand for service and credit may well show considerable variation, fluctuating from time to time, with changes in the business cycle, and from place to place, with the composition of the population, but it would seem that cash-and-carry merchandising could not reasonably hope to reach much if any more than 50% of the population. But all of this business cannot be credited to the chains since there are many independent cash-and-carry dealers who are making strong bids for this trade. The chains are thus limited to

‡ "Income in the United States, 1909-1918."

less than 50% of the grocery trade of the country if they continue to adhere to a cash-and-carry policy.

Let us now turn to the possible effects of a change of policy on the part of the chains. While it is true that theoretically, the chains may adopt a service-credit policy it is clear that such action would be a radical departure from their established custom, and could have the tendency to increase costs of operation. Indeed their reluctance to make such a change may be explained by the fact that their chief difficulty, finding satisfactory management, would be increased. Certainly it would require a superior type of man to handle a credit business. Careful discrimination as to credit risk would be essential else losses from bad debts might wipe out profits. A manager capable of exercising such judgment cannot be had for as low a salary as one who merely sells standardized merchandise for cash. Operating costs would be increased in at least three directions. Salaries would be greater, losses from bad debts could not be entirely avoided *, and accounting and collection expense would be augmented. In addition there would also probably be delivery and other service expenses incurred. Thus it must be concluded that a general shift of the chains from a cash-and-carry policy could at least weaken their competitive position decidedly and would also indicate a potential limit to further growth.

Chains Have Limit

The very bulwarks of the chain store, namely the greatly superior position from the standpoint of buying, and the economies practiced in selling, have been examined and shown to contain potential limits to the expansion of the chain stores. Thus in striking a balance of advantages and disadvantages it appears that the chain system is not, inherently at least, so markedly superior to the so-called "regular" manufacturer-wholesaler-retailer system as is commonly assumed. The buying advantages are probably not sufficient to

* Mr. Gorton James of the United States Department of Commerce in an address before the Marketing section of the American Management Association delivered on April 14, 1929, in Cincinnati, Ohio, stated that the extension of credit was the greatest weakness of independent retail grocers and that the Louisville, Kentucky, Survey of the grocery trade revealed losses from bad debts as high as 4.9% of net sales for grocers with sales less than \$5,000 per year. Not until sales exceeded \$50,000 annually did this figure fall to 1%, and the figure of .4% shown by the Harvard figures, Bulletin No. 52, 1924, as typical, is not reached until sales exceed \$100,000 per year

permit any great increase in selling costs without jeopardy to the chain's competitive advantage. It must be concluded that there are in theory at least real limits to the continued expansion of grocery chain systems and that these limits are inherent in the nature of the business organization and in the standardized practices which have become characteristic of it.

But the practical superiority of the chain which has resulted in its widespread success in one of the most highly competitive fields of American business cannot be ignored. The foregoing analysis would seem to indicate that this success has been due to the application of efficient modern business practices to one of the most inefficiently conducted lines of commercial activity. On the whole the chain store movement must be considered as an illustration of the salutary effects of competition upon the standard of business efficiency. By proving that food products can be profitably marketed at lower prices to the consumer the chains have stimulated the better merchants to a defense of their position. Those who would not change their outworn methods have either been eliminated or soon will be forced out by the march of progress.

Independent Must Reform

This study of the basis of chain store superiority indicates clearly that the independent merchant has nothing to fear from the chain store if he be willing to adjust himself to changing business conditions. As a merchandising specialist he occupies a strategically impregnable position. But he must specialize efficiently and leave no stone unturned that may block his success. He has no one but himself to blame for the present condition of the grocery business and no one but himself can help him. There is much of hope in the outlook, however. Even the little corner grocery without outside affiliations is, in many cases making a winning fight against its chain store competitor, according to experts from the Department of Commerce quoted in the *Christian Science Monitor* (October, 1928). In the same article Julius Klein, director of the Bureau of Foreign and Domestic Commerce is credited with the following statement:

"The recent tendency toward mergers among manufacturing concerns, and the growth in the chain store movement has led some observers to predict the eventual elim-

ination of the small manufacturer and merchant. The Department of Commerce holds no such belief. The resourcefulness and the freedom of action of the individual will always go far toward offsetting the advantages of large-scale operations of the large combinations.

"The vast majority of independent business men with native ability, and with a willingness to work, to utilize new methods, and to take advantage of new conditions and with a reasonable margin of capital, have as great opportunities for success today as ever before—in fact a greater opportunity, because of the steady advance in our living standards and buying power.

Certain Advantages

"For certain types of business the big concern has an undoubted advantage over its smaller competitor, but in those lines of merchandising where success depends mainly on taking advantage of changing trade opportunities, close, watchful contact with market conditions, and expert personal superintendence of operations, the small operator has many advantages over the large establishment.

"The neighborhood grocer can introduce those elements of personal attention and service which are much appreciated by the consumer and which cannot so readily be supplied by a vast impersonal corporation. This implies, of course, no disparagement whatever of the latter. The principal innovation introduced by the large corporation is better management and the recognized value of large scale economies; but big business has no copyright on profitable methods, and mere bulk is by no means necessarily synonymous with efficiency."*

Our analysis of the virtues and defects of the large-scale chain system would indicate that the "principal innovation" mentioned by Mr. Klein is offset, to some degree at least, by the limitations of human capacity for large scale management. Furthermore, the "recognized value of large-scale economies" have not appeared to be so great when carefully examined.

Final Analysis

In the final analysis the problem resolves itself into a conflict between

* Julius Klein in Foreword to "Practical Aids to the Independent Merchant." Department of Commerce Bulletin, 1928.

functional specialists in marketing and those who are endeavoring to absorb several distinct functions. The independent manufacturer, wholesaler, and retailer represents highly specialized marketing agencies whereas the chain represents a departure from functional specialization. This is especially true from the point of view of management. If it is contended that a management unit which must divide its attention between the distinct problems of manufacturing, wholesaling, and retailing is superior to separate management units each of which centers its entire efforts on the performance of one particular set of functions, then it must also be admitted that the principle of specialization has little validity. Few economists would go that far. From the point of view of productive efficiency the presumption is all in favor of the independent specialist in manufacturing, in wholesaling, and in retailing.

In conclusion of this phase of our problem it must be conceded that the wholesale grocer's position, while seriously impaired through shrinkage of his outlet due to chain store competition, is not without hope. In so far as there is a limit to the expansion of the chain store type of marketing, and a limit which may be approximately estimated at 50% of the retail trade, there still remains a considerable volume of business for the wholesale grocer. But there are other forces at work which tend to shrink still further the field of operations of the wholesaler. Co-operative associations of both consumers and retailers must be examined as possible substitutes for the old-line wholesale grocer. These remaining competitors for the wholesaler's functions will occupy our attention in the succeeding section.

Part III

CO-OPERATIVE MARKETING

Co-operation is one of the most abused of economic expressions and one which is given such varied meanings as to make an explicit definition an essential prerequisite to its use. When used in connection with marketing problems the word should mean the voluntary combination of like units for the purpose of performing certain merchandising functions with the objective of reducing costs or at least of securing the ordinary profits of the enter-

prise for the co-operators. Two types of co-operation may be mentioned in connection with this study, co-operative buying and co-operative selling.

The latter form has had such extensive success in the United States that it is clearly the most important type of co-operation in America today. But it has as yet very little bearing upon the problem of the wholesale distribution of prepared food products since it is primarily a method of marketing farm products, which are not usually included in the stock in trade of the wholesale grocer.* In so far as there is any competition from this type of co-operative it is analogous to that of the manufacturer who seeks to sell direct since in both cases forces from his "supply" side tend to supplant the wholesaler through the assumption of his functions. Since competition from co-operative selling is so exceptional at this time, as far as the wholesale grocer is concerned, there is ample justification for the omission of any further discussion of this problem.

Co-operative Types

Co-operative buying, however, must be given serious consideration. There are two distinct phases of this problem, consumer's co-operation and retailer's co-operation. Here, in each case, the competitive forces are those which, like the chain store, strike at the outlet of the wholesaler, that is tend to shrink the demand for his services.

Consumer's co-operation consists of an organization of consumers for the purpose of operating a retail store, thereby getting their grocery products at a reduced price made possible through the elimination of private profit. At the outset such stores may buy from wholesale grocers but very soon they attempt to make contacts with the manufacturer either directly or through the organization of co-operative wholesale houses. Consumer's co-operation has shown such great possibilities in England and other foreign lands that it must be deemed at least a potential competitive force in our own marketing system. This phase of co-operation has likewise had no in-

considerable history in the United States.

An Early Success

Quite successful attempts were made in this direction in New England as long ago as 1847 when the Workingmen's Protective Union was founded. This organization, later called the New England Protective Union, showed an expansion of sales from \$18,000 to \$180,000 in the three years from 1848 to 1851.* Other attempts followed both in New England and in other parts of the country but initial successes were followed shortly by failures until little or no trace of the movement was left by the close of the Civil War. Periodic efforts have been made to revive consumer's cooperation but heretofore a brief period of success and expansion has been followed by rapid decline or failure. The idea will not down, however, and is very much alive in the United States today. In 1915 it was estimated by the Department of Agriculture that there were some 275 consumer's cooperative stores doing a business of about \$14,500,000, or an average of nearly \$53,000 each.† The stores had a membership of over 60,000 cooperators.

In 1916 the Cooperative League of America was founded with the objective of popularizing the cooperative idea. This organization had a very able leader in the person of Dr. J. P. Warbasse and the result of its activities is shown by the growth of the movement up to 1920. The League's estimate of the size of the movement gave the number of societies as three thousand and the number of members as 500,000 in the United States in 1919. The estimates of the Bureau of Labor Statistics, which made an investigation of the movement in 1920, gave the number of societies as approximately 2,500 and the number of members as 775,000*. At that time the American movement was following the English Rochdale model and as many as ten cooperative wholesale societies were established. By 1919 the National Co-operative Association had been formed by federating the state and sectional wholesale societies. Branches were established strategically throughout the nation and plans were laid for a large development of cooperative marketing. The break in prices in 1920, however,

was too much for the the new organization and it failed.

Decline and Recovery

The extent of the business carried on by all cooperatives in 1920 was estimated at \$285,000,000.† Since then there was a decline in sales until 1923, followed by a rather steady recovery as is shown by Charts XI and XII.

A subsequent study made by the Bureau of Labor Statistics shows that the average retail cooperative society was handling \$122,649 worth of trade in 1920 and \$116,634 in 1925; and that the average wholesale society handled \$1,111,044 in 1920 and \$819,840 in 1925. Grocery stores, general stores handling groceries, and combined grocery and meat shops made up 85.7% of the number of cooperatives reporting. No estimate is made for the total grocery sales of cooperatives for either date but it must be considerably less than the \$285,000,000 given as total cooperatives sales for 1920. This is seen to be relatively insignificant when compared with retail grocery sales per annum roughly estimated at \$10,000,000,000 and wholesale grocery sales of over \$4,000,000,000 per year.* It is thus clear that the consumer's cooperative movement has little importance from the standpoint of our discussion. It must not be ignored, however, because it is a live and growing movement and one which has assumed rather large proportions in England.

Four Essentials

In view of this much greater expansion in England during a period of practically identical duration† the question which naturally arises is why has the American movement been so backward. This problem has been a much studied one and many arguments have been advanced to explain why consumer's cooperation has been slow to develop in the United States. Professor Francis G. Peabody of Harvard cites the four following conditions which he claims are essential to success in cooperative enterprise.‡ The movement must be an independent one; the population must be immobile; there must be a strong social urge to save; and finally there must be a spirit of

* In a very few instances the wholesale grocer has felt the effect of competition from the source of cooperative selling. In several sections of the country such as New York, Wisconsin and Washington the dairymen have combined on a cooperative basis not only to sell their raw produce but also to process or manufacture to some extent. In Washington the dairymen produce their own "Cooperative" brand of evaporated milk and market it directly to retailers in competition with nationally known brands handled by the wholesale grocers.

* Ware, Norman. "The Industrial Worker." Houghton-Mifflin, 1924.

† Bulletin No. 547. United States Department of Agriculture.

* Monthly Labor Review. Volume 15, pages 444-448, 1922.

† Monthly Labor Review. Volume 24, pages 20-26. January, 1927.

* National Wholesale Grocers' Association Bulletin 1925

† The Rochdale movement was established in 1844 in England.

‡ Ford, James. "Cooperation in New England." Introduction by Professor Peabody. Survey Association, Inc., New York, 1913.

cooperation, a feeling of unanimity of purpose. It is generally agreed that the absence of these conditions in America has been the chief cause of failure of cooperative efforts on the part of American consumers whereas their existence in England has contributed much to the success of the British movement. This is very likely true but probably to a lesser extent today than at any previous time, be-

On the other hand American co-operators have allowed politics rather than business judgment to govern in the selection of managers. Since politicians are not necessarily good business heads the results have frequently been far from desirable. Again good managers have been hard to hold because of the unwillingness of the co-operators to pay the necessary salaries. Co-operators are gradually awakening to the necessity of

Frankford Grocery Company.* This retail buying association was organized in the late 80's to provide a purchasing department for a group of Philadelphia retail grocers. It has had a very successful career and is said to be the largest of such organizations in the country today, having had sales of about \$6,000,000 in 1927.* The plan of the Frankford Grocery Company has been copied both in Philadelphia and elsewhere until some 96 such associations were noted in 1927.†

Chart XI.

SALES OF COOPERATIVE STORES IN THE UNITED STATES
(000 omitted)

Types of Societies	Number Reporting	1920	1921	1922	1923	1924	1925
Retail	185.....	22,690	18,812	17,604	19,195	19,839	21,577
Wholesale	3.....	3,333	1,825	1,642	1,975	2,207	2,460
Total*	204.....	27,004	22,236	21,592	25,021	26,192	28,544

* Includes items omitted here.

Chart XII.

TREND OF SALES OF COOPERATIVE SOCIETIES
Index Numbers of Average Amount of Business Per Society

Type of Society	1920	1921	1922	1923	1924	1925
Retail	100	82.9	77.6	84.6	87.4	95.1
Wholesale	100	54.7	49.3	59.3	66.2	73.8
Total*	100	82.3	80.0	92.7	97.0	105.7

* Includes other types of Societies.

cause it may be contended that, as far as the above limitations are concerned, a greater development of co-operation may be expected in America in proportion as economic conditions in this country approximate those which existed in England at the time the movement received its greatest impetus.

To be sure other factors, such as the earlier appearance and growth of the chain stores here, may interfere permanently with the growth of consumer's cooperation in America. One of the most serious obstacles to consumer's cooperation in the United States and one which has been responsible for no small part of the failures in cooperation has been the neglect to recognize the importance of good management. This has been true in a double sense. On the other hand it has been said that the independent American merchants have shown so much superiority over the corresponding British dealers that cooperatives in the United States have had to contend with superior competition whereas in England the cooperatives, themselves have easily surpassed the independents.

getting and keeping competent managers, so that here again the future may tell a different story.

Not Serious Competitors

On the whole it must be concluded that the more serious obstacles to consumer's cooperation in this country are now much less formidable than they have been. In fact it is not unreasonable to anticipate a somewhat larger development of that movement in the future. But for the present consumer's cooperation cannot be held to be a serious competitor for the wholesaler's functions since such organizations have failed to materially reduce his outlet.

The second phase of cooperative buying, retailer's cooperation, is of much more immediate significance. Associations of retailers with the objective of pooling their purchases and thereby eliminating the wholesale grocer are not new, but the development of chain store competition has given the movement added impetus. One of the earliest attempts in this direction was made by a group of retail grocers in Philadelphia under the name of the

Purpose of Cooperatives

The purpose of retail buying associations is to reduce prices to the co-operators so that they may either secure greater profits or meet such price competition as is given by the chain stores. The latter indeed have supplied one of the main stimuli to such co-operative attempts and have in addition provided the pattern for the form of business organization. As a means to the desired end many of the wholesaler's functions are neglected or shifted to other shoulders. Only a relatively small stock of staple products is usually carried. Salesmen are seldom or never employed; credit is greatly reduced, and free delivery is exceptional. Selling costs are thus made somewhat lower and prices consequently may be slightly reduced. But if any material reduction in price is to follow from this sort of marketing it must accrue from either lower costs of merchandise purchases or from more efficient and economical performance of the wholesaler's functions. The neglect of certain functions or the shifting of the burden of performance to others does not necessarily result in any reductions of marketing costs.

An examination of the comparative costs of doing business by cooperative buying associations and by regular wholesalers* fails to show any great savings accruing to the cooperatives on the score of greater economy or efficiency. Neither can it be expected that such associations can gain a great deal from the standpoint of purchasing. While statistics are lacking to verify the point, it is not probable that the average retail buying association is

* An interesting account of the history of this organization may be found in "Competition and Combination in the Wholesale Grocery Trade in Philadelphia," by W. L. Abbott, University of Penn., 1920.

* White, W. L. "Cooperative Retail Buying," Harvard Business Review, October, 1928.

† Ibid. Retail cooperative buying Associations are here shown to have grown from a dozen in 1908 to 96 in 1927.

* White, W. L. Ibid.

much larger than the typical wholesale grocery. On that assumption its scale of purchases would not be such as to permit of any better prices than the regular wholesale grocer secures. In fact if the retail buying association is to secure even as satisfactory prices as the independent wholesaler it must have as capable a purchasing agent as the latter. Cooperatives generally have been reluctant to pay adequate salaries to secure competent assistants, hence it may be plausibly contended that the normal buying association might actually prove to be at a disadvantage when it came to purchasing. Such difficulties are not inherent, however, so it is not impossible that they may be overcome.

Granted that possibility and assuming a large enough group of interested retailers it would seem that cooperative buying associations should be able to function as efficiently as a chain wholesale department. This would make possible some very real competition for both chain store and independent dealer since the advantages of the chain would be coupled with those of the independent merchant. The individual cooperators would retain the flexibility of separate management units under the direct supervision of an interested owner. But for the time being there seems to be no reason to impute any great significance to this phase of co-operation, since retailer's cooperation is handicapped by the same obstacles that lie in the path of consumer's cooperation. Until such problems have been solved neither consumer's nor retailer's cooperation can be considered a serious menace to the position of the independent wholesale grocer.

"Voluntary Chains"

Cooperative buying, however, presents still another facet for our scrutiny. Comparatively new in point of development, a type of organization, the voluntary chain, has recently appeared in the grocery trade. Mr. V. H. Pelz of the American Institute of Food Distribution estimated that there were in 1928 some 374 such organizations embracing about 54,000 retail grocery stores. These figures indicate a rate of growth unparalleled by even the chain stores since such organizations were comparatively rare or non-existent ten years ago.

The voluntary chain in form is quite closely allied to the ordinary chain and to retailer buying associations. The initiative for the organization comes in this case, however, immediately from

the wholesale grocer. The latter in his efforts to maintain his slippery footing has hit upon this expedient of fighting fire with fire, and has recognized and adapted to his own use the chain store principle.

Early Attempts

One of the first attempts in this direction was made in the Philadelphia market area some years ago when the wholesale grocers united in launching an organization known as "Community Stores, Incorporated".* All independent retail dealers were invited to join and many availed themselves of the opportunity. A distinctive emblem was selected and displayed by all members of the voluntary chain. The wholesale members provided certain "special" bargains which were given the widest publicity, the emphasis being upon price. These specials were sold to the retailers on such a basis that the chain stores "leaders" no longer had a monopoly in the territory. For a year this scheme served to carry the battle right into the chain store's camp. It seemed to provide both independent retailer and wholesaler with a satisfactory means of offense, but for some reason or other proved to be short-lived. The wholesale grocers discontinued the arrangement at the close of the year's trial, although no very satisfactory reasons for so doing were discernible.

Among other voluntary chains which are operating at the present time the largest is perhaps that known as the I. G. A. (the International Grocer's Alliance). Mr. J. Frank Grimes has been closely associated with the inception and growth of this organization. Other contemporary examples of the same principle may be found in the S. M. Flickinger Company of Buffalo, New York, Granger and Company also of Buffalo, Nation Wide Stores of Brockton, Massachusetts, and the Clover Farms Stores of Cleveland, Ohio. The description of a typical voluntary chain agreement may serve to bring out the principles involved and reveal the strength and weakness of this form of cooperative marketing.

A Typical Example

A large wholesale grocery company located in the middle-west organized a group of its retail customers into a voluntary chain some years ago. Agreements were drawn up and signed

* Abbott, W. L. describes the development of this experiment in "Competition and Combination in the Wholesale Grocery Trade in Philadelphia."

by both wholesaler and independent retailer. The provisions of these agreements were first, the retailer must display a distinctive emblem on the front of his store which emblem was to be advertised by the wholesaler. Secondly, the store front of the independent retailer must be painted a specified color. Third, each retailer must agree to pay a definite sum, let us say \$10.00 monthly, to which the wholesaler will make the necessary additions to defray advertising costs. Fourth, the wholesaler must provide regular advertising featuring the emblem and certain weekly specials in newspapers and handbills. Additional advertising, such as the use of the radio to assist in popularizing the idea and the name, might be provided by the wholesaler at his expense. Finally, the retailer must agree to have on hand and for sale as specified prices all merchandise featured in the advertisements as specials. Such merchandise might be secured from the wholesaler or any other source as far as the agreement was concerned. In this particular system the retailer was under no compulsion to purchase anything from the given wholesaler, a radical difference from the I. G. A. organization which compels purchase of all merchandise sold through the cooperating wholesale house.

From the retailer's standpoint the chief advantage of the first system arises from the fact that merchandise is provided each week for the "special" at prices that permit real competition with the chain stores. In many cases the advertising is also an additional gain to the retailer since the majority of the retail grocers of the neighborhood variety, could never make any general use of the newspapers, for costs would be too high in proportion to the territory reached, tributary to the individual trader's place of business. Under the cooperative scheme each retailer gets the benefit of the general advertising and pays but a small part of the cost.

Business Advice

Another advantage grows out of the wholesaler's cooperation in offering business advice. A staff of trained merchandisers are kept at work showing the retailer how to cash in on his advertising; how to improve his store arrangement; and how to raise the general level of his business efficiency.

Ultimately the retailer may look for lower costs on most of his stock, pro-

vided all cooperators purchase the major portion of their merchandise from the cooperating wholesale establishment. These lower prices to retailers would grow out of the major advantage to the wholesaler, a larger and steadier market. With a somewhat stabilized outlet the wholesaler would be in position to govern his purchasing activities in such a way as to get maximum results and minimum prices. For example the wholesaler would be in a position to approach the manufacturer with this sort of a proposition. "You want to enter this territory. To do so will cost you a certain amount for advertising and other selling expense. We can put your product into several hundred stores simultaneously and advertise them with our weekly announcement. What is it worth to you?" The chains have previously gained many concessions from manufacturers on this basis and the wholesaler who establishes a voluntary chain can now use the same method. Furthermore, the wholesaler is in a very satisfactory position to "push" his own private brands which usually show a longer profit than the nationally known lines.

Sometimes Irksome

On the whole both wholesaler and retailer seem to have all to gain and very little to lose by the voluntary chain arrangement. Some of the retailers no doubt may find the supervision of the wholesaler's representatives a bit irksome. They may resent the necessity of maintaining the standards set by the wholesaler on the score of neatness and general store appearance. But these objections are of minor importance as long as the plan results in greater profits.

The chief advantages from the wholesaler's standpoint lie in those difficulties connected with inaugurating

the system and keeping the retailers in line and satisfied. In some of the systems the agreement does not compel the retailer to purchase anything at all from the wholesaler. The retailer must, however, provide himself from some source with all advertised specials so that no consumer shall ever be turned away from an individual store of the voluntary chain because of lack of stock. This in fact compels the retailer to get his specials, at least, from the wholesaler. The wholesaler makes a careful check to be sure that this part of the agreement is fulfilled even though the purchase be made elsewhere. But the wholesaler can make such exceptional prices on the specials that there is no danger of the retailer going elsewhere for them. There is little or no profit in the featured merchandise, however, either to wholesaler or retailer.* Thus if retailers buy only specials from the wholesaler the latter stands to gain little from the relationship.

Danger to Wholesaler

There is another danger to the wholesaler, also. His regular retail customers who are not included in the voluntary chain may feel that they would prefer to take their business to other wholesalers. This danger may be met by passing on to all customers the price advantages gained by the new method of organization.

From the consumer's point of view the voluntary chain may offer prices comparable to those of ordinary chain stores while retaining the individual services of delivery and credit. The trend is toward cash-and-carry and away from service, however, and once that transition is made there would seem to be little choice between regu-

* The retailer must sell the advertised products at advertised prices or less but not at higher prices, according to the terms of the agreement above referred to.

lar and voluntary chains. To be sure the consumer would still have the advantage of the quicker interest of the owner in the latter case. The individual proprietor would be more apt to cater to the customer's preferences than would be possible for the chain store manager.

A Minor Disadvantage

But lack of uniformity in store make-up and in prices would be somewhat of a disadvantage as compared with the chains in which all store units are identical for a particular chain, and where price uniformity is the rule. With the separately owned and operated voluntary chain stores the only unity would be found in the color scheme of the store front and the prices of advertised specials. Other products might show considerable price variation between stores. This is only a minor disadvantage, however, and is more than offset by the advantages mentioned.

In conclusion it would seem that cooperative buying groups of the voluntary chain variety present very real possibilities for the wholesaler as a means of maintaining his position in the trade. They seem to be economical and efficient means of distribution which combine the advantages of the integrated chain store system with those of the specialized independent wholesaler-retailer method.

The foregoing discussion of cooperative marketing brings to a close the examination of all of the major competitors for the wholesale grocer's office. The manufacturer, the chain store and consumer's and retailer's cooperatives have in turn been subjected to our scrutiny. These competitive forces which we have just examined in detail will be weighed in the concluding section in an effort to formulate a tentative opinion regarding the outlook for the wholesale grocer.

Economist Weighs Factors for and Against Permanence of the Wholesale Grocer

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THE BULLETIN presents herewith Section IV, "The Permanence of the Wholesale Grocer," the fourth and final installment of "Competitive Forces in the Wholesale Marketing of Prepared Food Products," by Mr. Engle.

The first installment appeared in the November issue of THE BULLETIN and included Mr. Engle's Introduction, Section I, "The Marketing Mechanism", and Section II, "The Wholesale Grocer and His Function". The second installment, Section III, "Competitors for the Wholesale Grocer's Office", appeared in the December issue of THE BULLETIN. That issue also reproduced Part 1—The Manufacturer—of Section III. The January, 1930, issue of THE BULLETIN presented Part 2, "The Chain Store", of Section III, and also Part 3, "Cooperative Marketing",

In this study Mr. Engle has analyzed, probably for the first time in detail, the position of the wholesale grocer under strictly modern conditions. His analysis has been complete and practical. The study has deserved the widespread interest with which it has been received.

—Editor's Note.

Section IV.

THE PERMANENCE OF THE WHOLESALE GROCER

The foregoing analysis of the major competitive forces at work in the food products traffic would seem to indicate that there are at least some grounds for a defense of the proposition that an independent wholesaler of some description will continue to appear as a permanent part of the marketing system. This wholesale unit will be "independent" in the sense that it will consist of a number of separately owned and operated organizations each of which will continue to perform most of the functions now accredited to the wholesale grocer. There will be no necessary identity between the "independent" wholesaler of the future and the existing species of today. In fact if there is to be an independent wholesaler at all in the future very radical changes in the make-up of the organization and in the methods of performing the wholesale functions must be looked for.

A loose federation of non-competing wholesalers may emerge, for example, limiting to some degree the independence of the wholesaler; while cooperation with retailers may effect further changes, but the persisting wholesaler will still fall in the category "independent" as opposed to the mere departmentalization of wholesaling as illustrated by the chain. It is not unlikely, too, that the number of wholesalers will be considerably reduced, and a trend opposed to the present one toward localization may well be anticipated. That is the wholesaler of the future may become a sectional dealer, taking in a territory at least co-

extensive with a state's area, rather than a local dealer covering a relatively limited district.

Weight of Argument

In defense of this conclusion that the independent wholesaler will continue to exist, it is only necessary to bring together the major arguments developed in the preceding sections and to supplement them by indicating several minor points bearing on the problem. In the first place we have seen that there is little danger that the wholesaler's source of supply will ever be entirely cut off. It is true that the activities of manufacturer's seeking direct contact with retailers have threatened the wholesaler's position but we have concluded that the threat is not a serious one. To obtain direct contact involves the assumption and performance of the wholesaler's functions. But there is little or no reason to believe that the average manufacturer can perform these functions as economically as the wholesaler either by individual or collective direct selling or by extension of line of products. Furthermore, efforts to do so tend toward mergers of food producers and monopoly.

Mergers may result in a slightly better potential position for direct selling but the advantages are probably insufficient to permit of effective competition with the wholesaler in the performance of his functions. The other alternative, monopoly, cannot be seriously considered as a possible eventuality in food trade, since governmental interference would be certain to prevent it. Again the presence of so many small-scale producers in this trade would make any very effective monopoly little short of impossible to establish. If it should be established, however, the possibility of the continuous appearance of small-scale competitors would seriously threaten its effectiveness.

As To Chains

In the second place the wholesaler's source of supply has also been placed in some slight jeopardy by the chain store's manufacturing activities. But this attempt at integration cannot be looked upon as at all serious. It would be difficult to defend the proposition that an organization which is fundamentally a retail merchandising mechanism can diffuse its efforts and hope to attain as high a degree of efficiency in production as is possible for the specialist in manufacturing. The very fact that the chains are attempting to manufacture some of their own products will also tend to stimulate other manufacturers to greater efficiency. It may likewise have the additional effect of antagonizing the manufacturer and turning him back to the independent wholesaler and retailer. The development of a strong

feeling of cooperation among independent manufacturers, wholesalers, and retailers, actuated by the economic motive of self-preservation may very well result in an increased efficiency of production and distribution that will give the chain store very effective competition. The danger is certainly great enough to make it advisable for chain store executives to give pause before committing themselves to such an unwise policy as that of antagonizing the manufacturer through the assumption of his functions.

Some potential reduction of the wholesale grocer's source of supply has also been noted in connection with co-operative selling associations. But as long as the present situation continues there is little danger from this source since producer's selling cooperatives have thus far confined their activities to a type of goods which the wholesale grocer does not usually handle. However, the possibilities of consumer's cooperatives as potential manufacturers should be suggested as a very remote eventuality although for the present there is very little to be feared from these cooperatives on the score of reducing the wholesaler's purchasing market.

Position Well Defended

While we may safely conclude that the wholesaler's buying position is in little danger there is always the possibility of the unexpected. In case his source of supply should become endangered it is important to note that the wholesaler is not wholly defenseless. By resort to his own private brand he can put himself in a position to offer some very real competition to manufacturers, chain stores, and cooperatives alike. Every wholesaler should prepare himself for just such an emergency by the wise use of a private brand. The brand and trade-mark should first be selected and protected through proper registration. The wholesaler should also decide upon and always prescribe definite standards of quality, and specifications regarding weight, packing and the like for all goods put up under his brand. In general, only products which do not compete with the wholesalers more important sources of supply should be developed. Occasionally very advantageous purchases may be effected, as, for example, the entire output of a small canner. In fact, the wholesaler will find many opportunities to use his private brand without antagonizing the manufacturer in the least. By pursuing

such a conservative policy, he may cooperate fully with national advertisers and feel perfectly safe in so doing.

If the latter should show signs of falling away and attempting his elimination, the private brand can be brought to the front and advertised in competition with those of the recalcitrant manufacturers. This should prove so formidable a weapon that the manufacturer should hesitate to provoke its use. But neither should the wholesaler take the initiative in provoking hostilities through the excessive use of his private brand, since there is probably more to be gained through cooperation between the independent wholesaler and the manufacturer.

Formidable Competitor

In the second place we have examined the chief factors affecting the wholesaler's outlet. Here we have seen that the competition of the chain store system has served to reduce materially the demand for his services. This formidable competitor has apparently been responsible for at least some decrease in the number of wholesale grocers in the United States and for a noticeable falling off in sales by wholesalers. While statistics are few and unreliable in this industry there is some factual evidence that chain stores have had a phenomenal growth both in number and in sales—a growth which has been in excess of the normal increase in national prosperity. The presumption must be that the independent retail and wholesale grocers have been the sufferers both in point of numbers and in volume of sales. Statistics are lacking, however, hence this assumption cannot be verified inductively at present. By giving due consideration to the more reliable of the available data it is probably true that the grocery chains handled between a quarter and a third of the groceries sold at retail in the United States in the year 1928, and that their rate of expansion has been very rapid indeed.

In the face of this very respectable showing of the chains certain theories of limitation on chain store growth have been advanced. The success of the chains has been due to their ability to reduce prices to the consumer. The reduction of prices is a function of two variables, purchasing advantages and selling economies. The first of these variables has probably been much overrated. Buying advantages as we have seen depend very largely in the case of the chain upon the economies resulting from an integrated wholesale-

retail organization. The chain's retail outlet receives its goods at lower costs than the independent retailer not because the chain's wholesale department buys on much better terms than the independent wholesaler but because of the close relationship existing between the chain's wholesale and retail departments which makes possible a reduction in the costs of performing certain of the wholesaler's functions.

Selling Economies?

Selling economies, on the other hand, seem to be largely the resultant of two of the chain store's policies, the standardized merchandising of a relatively few staple products, and cash-and-carry selling. With the press of competition and particularly as a result of the growing demand for a complete food market under one roof there has been a marked tendency on the part of the larger chains away from the original restrictions on size and character of stock. The chain may cater to this demand, if it will, but by so doing it must inevitably increase its selling costs. One reason for the low selling costs of the chain has been the specialized general management which has made possible the selection and use of low salaried store managers. But little skill is required to follow specific instructions where the store and merchandise are highly simplified. Unquestionably some of this specialized general control may carry over to a more elaborate type of merchandising. But it must be admitted that a different type of store manager is essential if fresh fruits, vegetables and meats are to become part of the stock.

Skilled rather than unskilled labor will be required and this will at least tend to raise the cost of selling. Thus it seems clear that any departure from the policy of a simple stock of staple products must tend to break down the chain's advantage and at least indicate a potential limit to such rapid chain growth.

Cash and Carry Policy

The second policy referred to above, that of doing business on a cash-and-carry basis, seems to be more firmly established than the policy just discussed. The chain store literature, trade publications and the like, as well as chain store executives with whom the writer has talked, maintain that there will be no departure from cash-and-carry. A small chain in the West, however, has advertised a credit-service policy and a brief paragraph now and then adumbrates that possibility in the

case of the larger chains. If there is a strict adherence to the cash-and-carry method, the expansion of the chains has been shown to be limited by the demand for that sort of service. Demand for cash-and-carry, we have seen, must be limited by the size and distribution of incomes in the United States, and by the seasonal nature of farmer's incomes. For example the chain stores have actually been limited in their expansion in the Southeast by the inability of the consumers to pay cash.

It is conceivable, of course, that the chains may eventually be forced to yield to the pressure of demand for service-credit from nearly 50% of the consumers. If they do, however, the cost of doing business must increase, even as it must in the case of the extension of line to include perishable and fancy groceries. This again must weaken the chain's competitive position, and indicates another potential limit to chain store growth.

Other Obstacles

In addition to these major limitations certain other obstacles to the advance of the chain store movement are noteworthy, some of which originate with the chains themselves while others are inherent in the nature of independent grocery retailing. Some types of chains, for example, have found it unprofitable to locate in towns of less than 7,500 people. Just what the limit on size of locality for grocery chains may be does not seem to be definitely determinable, but it is probably much smaller than 7,500. Since half of our population resides in towns of 2,500 or less the very small towns would have to be covered in order to reach over 50% of the population. Furthermore, the chain store still encounters no little hostility based on the "buy at home" fallacy. Legislation has even been passed in some states aiming at the destruction of the chains.

Still another potential limit to chain store growth may be found to lie in the danger that chain stores will antagonize manufacturers through a too free emphasis on private brands of their own. Competitive forces have already reduced chain store prices on nationally advertised goods to such a point that there is little profit in handling them. Some chains are already specializing in their own private brands and advertising widely in competition with nationally known goods. The latter are used as cut-price "leaders" and discarded as soon as adver-

tising allowances are no longer forthcoming. The result may well be a war between nationally advertising manufacturer's and chain store's private brands with all of the products of the former marketed through independent dealers. It would seem that the power of the great national advertisers would be able to maintain a large number of independent food outlets in face of chain store competition. This would of course present a certain degree of limitation upon chain store growth should it actually materialize. But the advantages to the chains of maintaining friendly relationship with the manufacturers are probably too great to permit of such a serious cleavage.

Demand for Service

No analysis of the limitations on the growth of the chain store would be complete that failed to call attention to certain types of independent retailers which would seem to lie without the pale of chain store competition. In nearly every community of from 15,000 to 25,000 inhabitants or over there exists sufficient demand for at least one very high grade food establishment, that always has whatever the housewife may desire, regardless of how rare the product. Such a store makes no attempt to compete on the basis of price, since price is not the chief consideration with the consumer. Much of the stock is of necessity high in value, slow in turnover, and must therefore bear a high price to make the business profitable. There is little reason to believe that the chains will give this sort of independent any very severe competition. If attempted it might well prove unprofitable to the chain since costs would be much increased and the type of competition furnished by merchants of this sort is of the highest order. In fact, chain store competition may be said to have strengthened the hand of this type of grocer through the elimination of many of his inefficient competitors.

At the other extreme we find one of the least efficient of the independent retailers so entrenched that chain competition means little or nothing to him.*

* Of this type of retailer the following quotation from a summary in "Retail and Wholesale Trade" is noteworthy as showing a viewpoint which the author feels is unfounded in fact: "The average store with an annual volume of \$5,000 has little chance of surviving, and while the possibility of profitable operation increases with the annual volume, it is not until we reach a volume of more than \$50,000 that more than mere existence appears possible." "Retail and Wholesale Trade"—Chamber of Commerce of the United States publication, 1928. Page 69.

The "parlor grocer", so-called, utilizes a room or two of his dwelling for a store. His wife and children operate it while he follows his regular trade. He is open long before the chains in the morning and long after they are closed at night and Sundays and holidays make no difference to him. He has little or no knowledge of costs and, although his prices are generally high, he probably fails to cover all costs involved. But by continuing in business the real income of the family is generally somewhat greater than it could be under any other circumstances. He will probably never lack a demand for his services since most of his trade comes from people who have neglected to supply their grocery needs during regular hours of business. Hence he will probably hang on for a long time to come.

Local Chain Competition

Finally there is no inconsiderable group of independent merchants who by adoption of the cash-and-carry principle or through the organization of a chain of four or five stores have been able to more than hold their own with the large chains. Some of these dealers may develop large chains themselves it is true, but as long as they remain relatively small-scale merchants they must be dependent upon the wholesale grocer for most of their supplies.

Between the high grade food emporiums, the "parlor grocers" and the independent cash-and-carry dealers there would seem to be a considerable demand for the services of the wholesale grocer for an indefinite period, since most of these merchants would have no one else to look to for their purchases. There is also the fact to be pointed out, that all chains do not eliminate the wholesale grocer. One of the most successful of the chains in the western section of the country, the Skaggs' Stores, consistently purchased from the independent wholesaler rather than from the manufacturer, and it is claimed that the same policy is adhered to by the Safeway Chain which now includes the Skaggs' interests. How widespread this policy is cannot be determined but it probably affords the wholesaler but little business since most chains do their own wholesaling.

"Coops" Difficulties

In addition to the chain store's competition, the wholesaler's outlet is also endangered, as we have seen, by cooperative buying groups. Consumer's

cooperatives, while of no present importance, may in time threaten the wholesaler's outlet. Retailer's cooperatives have already developed a more serious competition through the establishment of retailer owned wholesale houses. The actual extent of this movement, however, is still small and is in addition faced with many obstacles. In order to be successful, progressive retailers who are willing to cooperate must first be discovered. Even if that be accomplished, difficulties are discernible from two other directions. Capital must be raised to establish the wholesale house, and competent management must be secured. The average retailer has little or no surplus capital available and cooperative buying groups have not established such a reputation for business sagacity and integrity as to appeal to the capital market. But the other obstacle is the more serious. Managers are selected, usually, on a political basis, a policy which tends to prevent the wise choice of efficient men.

Retailers probably could be expected to do a better job at selecting a manager than has often been true of consumer's cooperatives but even so there would still be the same reluctance to pay the salaries adequate to secure good men. Until these various difficulties have been overcome the wholesaler will find this sort of competition but a very minor thorn in his flesh.

Major Competitors

The major competitors affecting the outlet of the wholesale grocer have now been reviewed. His position is threatened to some degree by certain other forces however, which, while as yet immensurable, are probably not of very great significance. There is a certain amount of direct selling of grocery products to the consumer on the part of mail-order establishments—just how much it is difficult to say. But the presumption is that the chain store, with a price appeal equal to that of the mail-order house and the additional advantages of proximity to the consumer, and an actual display of the goods, has greatly reduced such sales. Again, while department stores have usually found groceries very unsatisfactory, and very few such outlets exist, the growth of chains of department stores under the control of the great mail-order houses may change this aspect of the situation. It all depends upon whether the "shopping" principle which dominates department store mer-

chandising so largely can be displaced by the mail-order people. The presumption is that they will be able to do very little towards altering people's buying habits and that the grocery department will be no more successful with them than with the ordinary department store.

Other competitive factors, such as the auto-grocery, an auto truck equipped with a complete miniature food market and following the practice of the old fish peddler; the automatic grocery, a self-service type in which food-vending machines are installed, are not of enough immediate significance to consider at length. Where existent they usually follow the chain principle, hence offer few new problems. At best it would seem that they could cater to but a limited demand. Apart from these limiting factors which tend to prevent competitors from cutting off altogether the wholesaler's outlet, there are also the more positive forces growing out of the wholesaler's own activities. It may be argued that the wholesaler has developed a defense mechanism to protect his outlet that is analogous to his potential use of the private brand as a weapon to protect him against direct selling. In both cases, however, the defensive measures are susceptible of being converted into rather effective offensive weapons as well. These measures fall into three classes, education, cash-and-carry wholesaling, and voluntary chains.

Keep Up Education

In the first place to protect and maintain his outlet the wholesaler has in many cases recognized the necessity of educating the retailer to a higher degree of efficiency. Much study has been given to this problem and more should be done by all independent wholesalers who are desirous of maintaining their own outlets. The retailer should be kept informed regarding all improved business practices. The wholesaler should see to it, that the results of governmental and educational research are made available for the retailer. Trade associations should also be encouraged. By persistent and intelligent effort in this direction much can be done to raise the level of efficiency among independent retail grocers.

The wholesaler should at the same time take a good dose of his own medicine. While the general level of efficiency in wholesaling is high and perhaps higher in the grocery trade

than in most trades,* there is room for improvement. While the wholesaler must of necessity carry a large and varied stock most wholesalers could profitably do considerable pruning. The recent survey of the grocery trade in Louisville, Kentucky, has brought out some interesting facts. For example, "a commodity analysis of coffee sales showed 4 blends under 9 brand designations, out of a total of 16 blends and 28 brands, to account for 88 per cent of total bulk coffee sales. In package coffee 5 blends out of 17 were found to account for 80 per cent of total country sales."† The same survey indicates that for one wholesaler an analysis of sales showed that 82% of the business came from 39% of the customers, namely those whose purchases per year were \$100 or greater.‡ Both of the above points indicate directions in which the wholesaler may look to increase his own efficiency. In fact, surveys analogous to that now being conducted in Louisville (1929) may well prove of no little value to wholesalers in other parts of the country and should be sponsored as part of the efficiency program of the wholesaler.

Cash-and-Carry Wholesaling

But the education of the retailer, while essential, is a slow process and in the meantime the wholesaler has found it imperative to turn to a second and more drastic measure to preserve his outlet. To enable the retailer to meet immediate chain store competition on the price basis some wholesalers have either established cash-and-carry departments or turned completely to that method of selling. Cash-and-carry wholesaling does permit the retailer to purchase his supplies on practically the same basis as the chain's retail outlet.* But the retailer has to

* A comparison of average wages paid in the wholesale trade in the 11 cities covered by the study of "Retail and Wholesale Trade" by the Chamber of Commerce of the United States shows that the grocery wholesalers paid in 1927 on the average of \$1,905 wages whereas the average for all trade was \$1,980. Total sales per establishment showed grocers averaging \$878,901 with average for all trades \$568,591. Average sales per dollar of wages were \$19.15 for all wholesale trade and \$27.45 for the grocery wholesaler. The ratio of average inventory to sales was for wholesale grocers 7.32%, a figure .42% below the average for all wholesale trades.

* Domestic Commerce, Volume III, No. 10, March 11, 1929. Page 3. U. S. Department of Commerce.

† Ibid. Page 3.

* One of the executives of a chain system recently informed the writer that he had examined the prices quoted by a cash-and-carry jobber and found them in every case as low as he could bill his own retail outlets.

perform many of the wholesaler's functions himself in order to gain this price advantage. The cash-and-carry stock is also usually much smaller than that carried by a regular wholesale house. This necessitates additional purchases from other wholesalers of items not kept in stock by the cash-and-carry house. Wholesalers claim that the cash-and-carry business can be carried on at a figure for costs that approximates half of the ordinary operating ratio and at the same time net them a better profit than the regular type of business. Cash-and-carry wholesaling, however, can never be the answer to the problems of the independent wholesalers and retailers. Only those retailers can be reached who are in a position to shoulder about half of the wholesaler's functions. Some means must be found to aid a greater percentage of the retailers.

Some wholesalers have adopted a third means of protecting their outlet, the voluntary chain system. We have seen that this method offers both wholesaler and retailer quite distinct advantages. A larger, steadier market for the wholesaler makes possible greater economy in purchasing. The chain's advantage of securing advertising allowances for introducing new products in a large number of outlets simultaneously is also made possible by the voluntary chain system. The retailer thus gains the chain's advantages of better prices, cooperative advertising, and the appearance of being a chain store, as well as the independent's superiority of direct supervision by the owner and greater flexibility of management.

The Voluntary Chain

The disadvantages lie in the necessity of continual supervision on the part of the wholesaler. This is an expense to him and an annoyance to the retailer. Again, individual peculiarities crop out much more noticeably in the case of the voluntary chain than in the completely integrated chain system. By painting them alike on the outside the separate stores are not made uniform, and the consumer will find some attractive and some untidy. More important than this, prices may differ from store to store also. Nevertheless, once the independent retailer realizes the necessity for co-operating and can be shown that he can make more profits that way than any other way, the disadvantages may be overcome or overlooked at least.

Apart from these methods the wholesaler may also find some relief in seeking out and developing new outlets. Institutional selling, while not new in the trade, was long considered unethical. There seems to be no substantial basis for this attitude at present. It grew out of the assumption that the retailer units should be allowed to handle all business with hotels, restaurants, hospitals, and the like and that competition for such business was in effect competition with one's customers. This assumption may have been well founded in fact at one time, but today there are probably very few institutions which do not purchase at wholesale whenever possible. The chain stores may be gaining some of this business but there is still room for the independent wholesaler in this direction. Frequently bids have been made successfully on government orders for such departments as those of War, the Navy, and the Interior, which not only give the wholesaler a very desirable volume but show a good profit also.

In Conclusion

In conclusion it would seem that available evidence indicates that there are possibilities in the food products trade for independent wholesalers, purchasing from independent producers and selling to independent retailers. The independence of all three may be limited by the necessity for much closer cooperation than has been characteristic of the past, but there should still remain room for separate ownership, for the initiative of the individual, and for the greater flexibility which comes from the independent in industry and trade. If this possibility is actually to materialize, however, it will be necessary for all independent merchants to utilize to the utmost every avenue open to them as specialized competitors for a place in the food industry. The chain store system has set high standards of efficiency in an industry which sorely needed reform. The chain store has discovered and filled a definite need in the community and is entitled to the success it has achieved. Independent retailers and wholesalers alike should recognize this fact and proceed to clean their own doorsteps before criticizing the chains. A failure to do so will go far toward giving over to the chains a much larger share of the grocery business of the country than they now enjoy.

In the final analysis those marketing agencies must tend to prevail which can perform most efficiently the functions demanded of them. If the nature of the demand is such that these functions fall in quite distinct and definite classes it would seem that there were possibilities for several distinctive types of marketing agencies to perform them. If the independent wholesale grocer is to be one of these agencies it is essential that he discover his proper channel and shape his course accordingly.

